TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1955

No. 74

UNITED STATES OF AMERICA, PETITIONER

vs.

LESLIE SALT CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED MAY 1[illegible], 1955
CERTIORARI GRANTED JUNE 6, 1955

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No. 13873

United States Court of Appeals
for the Ninth Circuit

UNITED STATES OF AMERICA,
Appellant,

vs.

LESLIE SALT COMPANY,
Appellee.

Transcript of Record

Appeal from the United States District Court for the Northern District of California, Southern Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—8-14-53

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

LLOYD H. BURKE, ESQ.,
United States Attorney;

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Assistant United States Attorney,
San Francisco, California;

H. BRIAN HOLLAND, ESQ.,
Assistant Attorney General;

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For Appellant.

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111 Sutter Street,
San Francisco 4, California,

For Appellee.

District Court of the United States for the Northern District of California, Southern Division

No. 30871

LESLIE SALT COMPANY,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

EXCERPTS FROM CIVIL DOCKET

1951

Sept. 12—Filed complaint, issued summons.

Sept. 14—Filed Summons Ret. Ex. Sept. 13, 1951.

Nov. 7—Filed answer of defendant.

1952

Nov. 24—Ordered assigned to Judge Goodman for trial this date.

Nov. 24—Court trial Arguments heard, exhibits introduced and case ordered submitted on briefs to be filed 10-20-10 days. Case set Jan. 6, 1953, for subm. (Goodman.)

1953

Jan. 13—Ordered case now submitted.

Jan. 29—Filed memo. decision of court. (Judgment for plaintiff. Findings, conclusions and judgment to be prepared pursuant to rules.) (Goodman.)

Feb. 3—Filed plaintiff's proposed findings & conclusions.

1953

Feb. 17—Filed defendant's proposed findings of fact.

Mar. 2—Filed findings & conclusions.

Mar. 2—Filed judgment for plaintiff vs. deft. in sum $4400.00 with interest from Oct. 24, 1950, and costs.

Mar. 3—Entered judgment. Mailed notices.

Mar. 5—Filed memo. (letter) of costs by pltff.—$15.00.

Apr. 30—Filed notice of appeal by United States.

Apr. 30—Filed appellant's designation of record on appeal.

Apr. 30—Filed statement of points upon which appellant intends to rely.

June 9—Filed order extending time for appellant to docket record on appeal to July 7, 1953.

June 11—Filed reporter's transcript of proceedings, Nov. 24, 1952.

District Court of the United States for the Northern District of California, Southern Division

No. 30871

LESLIE SALT CO.,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

Leslie Salt Co., plaintiff in the above-entitled action, complains of the defendant and alleges:

I.

That this action is brought under Title 28, United States Code, Section 1346 (a) (1) for the recovery of documentary stamp taxes erroneously and illegally assessed and collected by the Commissioner of Internal Revenue from said plaintiff. Plaintiff's claim does not exceed the sum of $10,000.00, and arises under the Internal Revenue Laws of the United States as hereinafter more fully set forth.

II.

Leslie Salt Co., plaintiff above named, is now and at all times mentioned was a corporation created, organized, and existing under and by virtue of the laws of the State of Delaware, duly qualified to do and doing business in the State of California, with its principal place of business located in the City and County of San Francisco of said state.

III.

That plaintiff seeks to recover from defendant the sum of Four Thousand Four Hundred Dollars ($4,400.00), together with legal interest thereon from October 24, 1950; that said sum of $4,400.00 represents the net amount of United States Internal Revenue documentary stamp taxes paid by plaintiff on or about the 24th day of October, 1950, solely by reason of the wrongful and illegal assessment and collection thereof by the United States Collector of Internal Revenue at San Francisco, California, as is hereafter set forth.

IV.

That on or about the 24th day of October, 1950, plaintiff received from the Collector of Internal Revenue in San Francisco, California, a notice and demand for tax, wherein and whereby demand was made upon plaintiff that it pay the sum of $4,400.00 as stamp taxes due in connection with the execution and delivery by plaintiff of two promissory notes in connection with the transactions hereinafter set forth; that as demanded in said notice and demand and on or about the 24th day of October, 1950, plaintiff did pay to said Collector of Internal Revenue at San Francisco, California, the sum of $4,400.00; that said payment was made solely in order to avoid the penalties threatened to be assessed and asserted against said plaintiff by said Collector.

V.

That on or about the 29th day of March, 1951, and within two years after the payment of said tax, as in Paragraph IV above alleged, plaintiff did file with the United States Collector of Internal Revenue at San Francisco, California, a claim for refund of said taxes illegally demanded and collected as aforesaid; that a true and correct copy of said claim for refund is attached hereto, marked Exhibit A, and made a part hereof; that said claim for refund was duly prepared and filed on Form No. 843 furnished to plaintiff by defendant and signed by Sheldon Allen, treasurer of plaintiff, the claimant therein; that at the time of the execu-

tion of said claim for refund said Sheldon Allen was the duly elected and acting treasurer of plaintiff invested with full power and authority to sign said claim on behalf of plaintiff.

VI.

That on or about the 20th day of July, 1951, the Commissioner of Internal Revenue forwarded to plaintiff a letter advising that plaintiff's said claim for refund had been rejected in full; that said notice of rejection from said Commissioner to plaintiff was dated July 20, 1951.

VII.

That no part of said documentary stamp tax paid to defendant by plaintiff on or about the 24th day of October, 1950, in the sum of $4,400.00, has ever been repaid, refunded, or remitted to plaintiff, and no part thereof has been allowed to plaintiff by way of a credit against any other taxes due or claimed to be due from it to defendant.

VIII.

That under date of February 1, 1949, plaintiff did enter into a loan agreement with the Pacific Mutual Life Insurance Co. providing for a loan of $1,000,000.00 to plaintiff, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of $3,000,000.00 to plaintiff; that on or about February 15, 1949, and pursuant to said agreement, plaintiff did execute and deliver to said Pacfic Mutual Life Insurance Co. and Mutual Life Insurance Company of New York

its promissory notes dated on the face thereof February 1, 1949, in the amounts of $1,000,000.00 and $3,000,000.00, respectively; that said notes were not corporate securities or debentures within the meaning of Section 1801 of the Internal Revenue Code, but were the simple promissory notes of plaintiff evidencing its indebtedness to said insurance companies as aforesaid, and were not subject to the documentary stamp tax assessed against plaintiff by said Collector of Internal Revenue as aforesaid.

IX.

That by reason of the illegal and erroneous assessment and collection of said documentary stamp taxes from plaintiff as aforesaid, defendant became and is now indebted to plaintiff in the sum of $4,400.00, together with interest thereon from October 24, 1950.

Wherefore, plaintiff prays for judgment against defendant as follows:

1. For said sum of Four Thousand Four Hundred Dollars ($4,400.00), together with interest thereon from October 24, 1950;

2. For its costs of suit herein incurred; and

3. For such other and further relief as the Court may deem meet in the premises.

/s/ WALTER C. FOX, JR.,

CHICKERING & GREGORY,

Attorneys for Plaintiff.

EXHIBIT A

Form 843
Treasury Department

Claim

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

☒ Refund of Taxes Illegally, Erroneously, or Excessively Collected.

☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

☐ Abatement of Tax Assessed (not Applicable to Estate, Gift, or Income Taxes).

State of California,
City & County of San Francisco—ss.

Name of taxpayer or purchaser of stamps: Leslie Salt Co.

Business address: 505 Beach Street, San Francisco 11, California.

Residence ....

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: San Francisco.

2. Period (if for tax reported on annual basis,

prepare separate form for each taxable year) from ...., 19.., to ...., 19..

3. Character of assessment or tax: Documentary Stamp Tax.

4. Amount of assessment, $4,400; dates of payment, October 24, 1950.

5. Date stamps were purchased from the Government ....

6. Amount to be refunded: $4,400.

7. Amount to be abated (not applicable to income, gift, or estate taxes)..................$......

8. The time within which this claim may be legally filed expires, under Section 3313 of Internal Revenue Code on October 25, 1954.

The deponent verily believes that this claim should be allowed for the following reasons:

Under date of February 1, 1949, taxpayer entered into a loan agreement with Pacific Mutual Life Insurance Company providing for a loan of one million dollars to taxpayer, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of three million dollars to taxpayer, each loan to be evidenced by a note of taxpayer payable to the lender. Said agreements also provided that the lenders on demand would be entitled to new sinking fund notes of taxpayer in exchange for said notes. Copies of said agreements have been delivered to the Bureau of Internal Revenue and by this reference are incorporated herein.

The Commissioner of Internal Revenue demanded documentary stamp tax in the amount of $4,400

on these two promissory notes, which has been paid, and refund of this amount is demanded upon the following grounds:

1. The promissory notes are not subject to the tax imposed by Section 1801 of the Internal Revenue Code, or any other documentary stamp or other tax.

2. The promissory notes are not debentures, or any other type of corporate security subject to any such tax.

3. The promissory notes are non-negotiable, and as such are mere contractual obligations possessing none of the attributes of a taxable corporate security.

Section 1801 of the Internal Revenue Code does not tax promissory notes and these instruments are promissory notes and nothing more. Statutory taxes like this stamp tax are to be construed strictly and imposed only upon the documents specifically designated in the statute. See United States v. Isham, 17 Wall. 496.

The notes in question must be considered by themselves alone and one cannot look through their form to their alleged substance, as the Commissioner is doing, and say that they are debentures and therefore subject to the stamp tax. In considering instruments subject to the stamp tax, the rule of looking through form to substance is not followed. In United States v. Isham, supra, Lederer v. Fidelity Trust Co., 267 U. S. 17, and numerous other cases, it has been held that in determining whether or not a stamp tax is due on

a certain document, the form and terms of the instrument are controlling.

The Commissioner claims that these notes are debentures, basing his classification on General Motors Acceptance Corporation v. Higgins, 161 F. 2d 593. The instruments in that case, however, are readily distinguishable from those involved here. The notes in the G.M.A.C. case were engraved and issued in series bearing serial numbers. There were eighty-four notes in denominations ranging from $100,000 to $1,000,000 and, with the exception of thirteen of the notes, they were payable to bearer. The notes there involved were patently debentures for all were exactly alike and carried every evidence of a debenture issue except for the absence of a trust indenture. On the other hand, in the case of Leslie Salt Co. there were only two notes given, both being in the form of ordinary promissory notes except for a reference in each note to the agreement of February 1, 1949, which sets forth the terms on which the loan was made. The whole arrangement was nothing more than an ordinary commercial transaction in the nature of a simple contract between the parties to borrow and lend money, evidenced by non-negotiable promissory notes. As such, the transaction was not an issuance of debentures or corporate securities.

Not only are these notes not debentures, but they do not constitute any other kind of corporate security. In order to be subject to the stamp tax, the instruments of indebtedness must not only be bonds, debentures, certificates of indebtedness, or

instruments bearing coupons or in registered form, but must also be such as are generally known as corporate securities. In Wilkinson v. Mutual Bldg. & Sav. Ass'n, 13 F. 2d 997, where it was held that the instruments in question were not bonds, but were promissory notes, the Court said at page 999:

> "* * * We have not known of a corporate security that has not (1) negotiability; (2) a fixed or ascertainable time of full payment, and (3) a fixed sum to be repaid. * * *"

The promissory notes of Leslie Salt Co. are not negotiable because of the reference in them to the agreement setting forth the terms on which the loans were made. Under the provisions of the Uniform Negotiable Instruments Act, in effect both in California and in New York, and the decisions construing the same (see 10 C.J.S. 529 and cases cited there in note 82; 3 R.C.L. 883, 884), a reference to an agreement in a promissory note renders the note non-negotiable, for the terms of the agreement must be considered as part of each note.

Since the notes are non-negotiable, they are not corporate securities (Wilkinson v. Mutual Bldg. & Sav. Ass'n, supra) and therefore are not subject to the stamp tax.

Even if the notes in question were debentures within the usual meaning of the term, they would not be taxable because they were not "issued * * * with interest coupons or in registered form," as required for taxability by Section 1801 of the Internal Revenue Code. Moreover, not only because they are not, standing alone, of such type, but also

because they were not issued with interest coupons or in registered form, the notes could not, under the terms of that Section, fall within the classification of "instruments * * * known generally as corporate securities," as recognized by Department Regulation 26 C.F.R. 113.55. It is clear, of course, that the notes are not "bonds" or "certificates of indebtedness" within the meaning of the Section or the Regulations of the Department. Being merely promissory notes and nothing more, instruments of the type here involved are not subject to stamp tax and have not been since the repeal of that tax on promissory notes by the Revenue Act of 1924. This view is supported by the Commissioner's Special Rulings dated July 14, 1948, (Letter to Home Title Guarantee Co., 1949 Prentice-Hall Federal Tax Service, par. 76,130) and June 23, 1949, (1949 Prentice-Hall Federal Tax Service, par. 76,282).

The Section should in this case be construed to avoid double taxation upon what is, in essence, a single transaction. Since the lenders can, under the agreements in question, request the issuance of new sinking fund notes under a specified trust indenture in exchange for the notes in question, and since these new notes would, by the same token, be subject to the tax imposed by Section 1801, the Section should be construed, in order to avoid this double taxation, as not imposing a tax on the notes here involved.

Finally, the issuance of these notes involves a unique method of financing and represents a con-

sidered choice, dictated by sound legal and business reasons, as between note and debenture issues. A note issue differs in material respects from a debenture issue and such factors as relative expenses of issue, legal expenses, printing costs, terms, costs of capital and relation of fixed and other charges to other corporate obligations enter into the selection of this method of what is essentially private financing having none of the characteristics which typically render debentures attractive and salable to the general public. The convertible feature of these notes in itself represents a postponement of financing having the characteristics of debenture financing.

It is, therefore, the position of taxpayer that said notes, being non-negotiable, and on their face ordinary promissory notes, are mere contractual obligations possessing none of the attributes of a taxable security and hence not subject to the stamp tax.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

March 29, 1951.

/s/ LESLIE SALT CO.,
By SHELDON ALLEN,
Treasurer.

[Corporate Seal.]

[Endorsed]: Filed September 12, 1951.

[Title of District Court and Cause.]

ANSWER

Now comes the United States of America, the above-named defendant, by United States Attorney and, for answer to the complaint filed herein, admits, denies and states, as follows:

I.

Paragraph numbered I is denied, except it is admitted that plaintiff's claim does not exceed $10,000.

II.

Paragraph numbered II is admitted.

III.

Paragraph numbered III is denied, except it is admitted that the plaintiff paid to the Collector of Internal Revenue for the First District of California on October 26, 1950, the amount of $4,400.

IV.

Paragraph numbered IV is admitted.

V.

Paragraph numbered V is admitted, except that it is denied that any part of said taxes was illegally demanded or collected. It is admitted that the Exhibit A to the complaint is a true copy of the claim for refund filed by the plaintiff, but any statement therein contained which is not expressly admitted herein is hereby denied.

VI.

Paragraph numbered VI is admitted.

VII.

Paragraph numbered VII is admitted.

VIII.

Paragraph numbered VIII is denied, except it is admitted that under date of February 1, 1949, plaintiff entered into a loan agreement with the Pacific Mutual Life Insurance Company, providing for a loan of $1,000,000 to plaintiff and that plaintiff entered into a like agreement with Mutual Life Insurance of New York providing for a loan of $3,000,000 to plaintiff; and that on or about February 15, 1949, and pursuant to said agreements plaintiff executed and delivered to said Pacific Mutual Life Insurance Company and the Mutual Life Insurance Company of New York its certain instruments dated February 1, 1949, evidencing the loans of $1,000,000 and $3,000,000, respectively.

IX.

Paragraph numbered IX is denied.

Wherefore, the defendant, having fully answered prays that the plaintiff take nothing and that the defendant recover its costs.

/s/ CHAUNCEY F. TRAMUTOLO,
United States Attorney.

By /s/ CHARLES ELMER COLLETT,
Assistant United States Attorney.

[Endorsed] Filed November 7, 1951.

[Title of District Court and Cause.]

MEMORANDUM DECISION

Goodman, District Judge.

26 USC 1801[1] imposes a tax of 11 cents on each $100.00 of face value, inter alia, upon all "debentures" issued by any corporation.

Plaintiff corporation owed large sums of money to certain banks. In order to fund these loans and to obtain needed working capital, it borrowed $1,000,000 from Pacific Mutual Life Insurance Company and $3,000,000 from Mutual Life Insurance Company of New York. It executed promissory notes for $1,000,000 and $3,000,000, respectively; to the two insurance companies. Simultaneously it executed agreements with the insurance companies, by which its business activities and the handling of its funds were circumscribed to protect the insurance companies and safeguard payment of the notes as therein provided.[2]

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[1] "§1801 Corporate securities.

"On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents" * * *

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[2] The agreements were collaterally executed specifically for the purpose of safeguarding and insuring payment of the loans by the borrower to the lender. They were not the kind of collateral or trust agreements traditionally used as the foundation or basis for the issuance of corporate obligations or securities.

The Collector of Internal Revenue assessed and collected from plaintiff a tax of $4,400 upon the two notes, upon the ground that the notes were "debentures," as provided in 26 USC 1801. Plaintiff duly filed a claim for refund, alleging that the promissory notes were "promissory notes" and not debentures. This suit followed upon denial of the claim for refund.

There was a time when promissory notes issued in commercial transactions were subject to the payment of stamp taxes.[3] These taxes, however, were later repealed.[4] And now stamp taxes are payable only upon corporate securities as defined in 26 USC 1801.

Unless the two promissory notes in question are "debentures," they are not subject to the tax. No more so than the notes that plaintiff gave the banks to cover its previous borrowings.

There has been much technical discussion in the briefs, and in cases cited, concerning the meaning and definition of the term "debentures." Suffice it to say that, in my opinion, the two promissory notes are just what they purport to be, namely, obligations to repay the two insurance companies the money the plaintiff borrowed from them. They do not have the characteristics that would make them debentures, either as defined in or purposed by the statute. The Collector cannot, by some feat of catalytic baptism, turn a plain obligation to re-

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[3] 42 Stats. 305. Revenue Act of November 23, 1921.

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[4] 43 Stats. 352. Revenue Act of June 2, 1924.

pay a specific sum of money to a specific lender" into a taxable security.

There does exist some disagreement of authority as to what, in specific cases, does or does not constitute a "debenture." The Government has cited General Motors Acceptance Corporation v. Higgins, 161 F. 2d 593 (2 Cir. 1947), and Commercial Credit Co. v. Hofferbert, 188 F. 2d 574 (4 Cir. 1951). The latter case was a per curiam affirmance of a District Court's opinion and decision, 93 Fed. Supp. 562 (Md. 1950). The facts in General Motors Acceptance Corp. vs. Higgins are different. The facts in Commercial Credit Co. v. Hofferbert are similar.

But later decisions in Allen v. Atlanta Metallic Casket Co., 197 F. 2d 460 (5 Cir. 1952); Belden Mfg. Co. v. Jarecki, 192 F. 2d 211 (7 Cir. 1951), and Shamrock Oil & Gas Co. v. Campbell, 107 Fed. Supp. 764 (N. D. Texas 1952), cited by plaintiff, appear to be more apropos and persuasive here.

Expert testimony was given here as to the meaning, particularly in the commercial world, of the term "debenture." The Government moved to strike the testimony and the Court reserved ruling on the motion. It now denies the motion. But I attach no weight to the testimony. For I hold that the issue is decidable, and I do decide it, upon the documents and the stipulated facts.

Judgment will go for plaintiff as prayed upon findings to be presented pursuant to the Rules.

Dated: January 29, 1953.

[Endorsed]: Filed January 29, 1953.

[Title of District Court and Cause.]

PLAINTIFF'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Pursuant to the Court's Memorandum Decision, signed and filed January 29, 1953, and Rule 5 (e) of the Rules of Court of the United States District Court for the Northern District of the State of California, plaintiff proposes the following as findings of fact and conclusions of law:

Findings of Fact

I.

That plaintiff is now and at all times herein mentioned was a corporation organized and existing under and by virtue of the laws of the State of Delaware, and duly qualified to do and doing business in the State of California, with its principal place of business located in the City and County of San Francisco of said state.

II.

That prior to February 1, 1949, plaintiff carried on negotiations with the Pacific Mutual Life Insurance Co. and Mutual Life Insurance Company of New York seeking a loan from said two insurance companies; that no person or persons not employed by or a director of one of said three corporations participated in said negotiations; that said negotiations resulted in agreement as to the terms of a loan agreement with each of said insurance companies together with the terms of a prom-

issory note to evidence each of said loans; that said terms were reduced to writing by said lenders for execution; that under date of February 1, 1949, plaintiff did enter into a loan agreement as so prepared with the Pacific Mutual Life Insurance Co. providing for a loan of $1,000,000 to plaintiff, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of $3,000,000.00 to plaintiff; that said agreements were collaterally executed specifically for the purpose of safeguarding and insuring payment of the loans by the borrower to the lenders; that said agreements were not the kind of collateral or trust agreements traditionally used as the foundation or basis for the issuance of corporate obligations or securities; that on or about February 15, 1949, and pursuant to said agreements plaintiff did execute and deliver to said Pacific Mutual Life Insurance Co. and Mutual Life Insurance Company of New York all documents required by said loan agreements, including its two promissory notes dated on the face thereof February 1, 1949, in the amounts of $1,000,000.00 and $3,000,000.00, respectively; that said notes are not engraved, and are not issued in registered form and do not have nor have they had coupons attached; that said two promissory notes are what they purport to be, namely, obligations to repay the two insurance companies the money the plaintiff borrowed from them, and do not have the characteristics that would make them debentures as said term is commonly defined.

III.

That on or about the 24th day of October, 1950, plaintiff received from the Collector of Internal Revenue of San Francisco, California, a notice and demand for tax, wherein and whereby demand was made upon plaintiff that it pay the sum of $4,400.00 as stamp taxes due in connection with the execution and delivery by plaintiff of said two promissory notes in connection with the transactions hereinabove set forth; that as demanded in said notice and demand, and on or about the 24th day of October, 1950, plaintiff did pay to said Collector of Internal Revenue at San Francisco, California, the sum of $4,400.00; that said payment was made solely in order to avoid the penalties threatened to be assessed and asserted against said plaintiff by said Collector.

IV.

That on or about the 29th day of March, 1951, and within two years after the payment of said tax plaintiff did file with the United States Collector of Internal Revenue at San Francisco, California, a claim for refund of said taxes; that said claim for refund was duly prepared and filed on Form No. 843 furnished for plaintiff by defendant and signed by Sheldon Allen, treasurer of plaintiff, the claimant therein; that at the time of the execution of said claim for refund said Sheldon Allen was the duly elected and acting treasurer of plaintiff invested with full power and authority to sign said claim on behalf of plaintiff.

V.

That on or about the 20th day of July, 1951, the Commissioner of Internal Revenue forwarded to plaintiff a letter advising that plaintiff's said claim for refund had been rejected in full; that said notice of rejection from said Commissioner to plaintiff was dated July 20, 1951.

VI.

That no part of said documentary stamp tax paid to defendant by plaintiff on or about the 24th day of October, 1950, in the sum of $4,400.00, has ever been repaid, refunded, or remitted to plaintiff, and no part thereof has been allowed to plaintiff by way of a credit against any other taxes due or claimed to be due from it to defendant.

VII.

That debentures as said term is used and understood in business and financial circles are unsecured promises to pay, are negotiable in form, generally are printed in denominations of $1,000.00 with covenants by the borrower printed on the front or back, and are accompanied by a trust indenture providing for a trustee to protect the rights of the lenders in accordance with the terms of said indenture.

VIII.

That debentures as said term is used and understood in business and financial circles are sold as other corporate securities are sold in that there is generally a public offering through the channels

of investment bankers and investment banking groups, including dealers, and terms of the debentures and accompanying indenture are fixed by negotiation between the issuer and the buying investment banker or bankers or, in case the issue is sold by competitive bidding, solely by the issuer; that it is customary to advertise a sale of debentures by an accompanying circular or prospectus.

IX.

That debentures as said term is used and understood in business and financial circles are constantly bought and sold and otherwise traded in after issuance; that non-negotiable promissory notes of the size of the notes executed by plaintiff are not so traded in after issuance.

Conclusions of Law

I.

That this Court has jurisdiction of the subject matter and of the parties.

II.

That the instruments with respect to which the tax here involved was paid are non-negotiable promissory notes.

III.

That said instruments are not bonds, debentures, or certificates of indebtedness, or instruments, however termed, issued by a corporation with interest coupons or in registered form known generally as corporate securities, as those terms are used in

Section 1801 of the Internal Revenue Code, 26 U.S.C.A. §1801, and were and are not subject to stamp tax under that section or any other section of the Internal Revenue Code.

IV.

That the tax, the recovery of which is sought in this action, was wrongfully and illegally collected and plaintiff is entitled to recover said tax in the amount of $4,400.00, together with interest and costs as provided by law.

Dated: February 3, 1953.

/s/ WALTER G. FOX, JR.,

CHICKERING & GREGORY,
Attorneys for Plaintiff,
Leslie Salt Co.

Receipt of copy acknowledged.

[Endorsed]: Filed February 3, 1953.

[Title of District Court and Cause.]

DEFENDANT'S PROPOSED FINDINGS OF FACT

During all times hereinafter mentioned the plaintiff was a Delaware corporation with the right to do business in California and with its principal place of business located in the City and County of San Francisco, California.

On February 1, 1949, the plaintiff entered into

an agreement with the Pacific Mutual Life Insurance Co., providing for a loan of $1,000,000 and entered into a like agreement with the Mutual Life Insurance Company of New York providing for a loan of $3,000,000.

On February 15, 1949, pursuant to the agreements, the plaintiff executed and delivered to each insurance company an instrument styled "3¼ Sinking Fund Promissory Note," in the amounts of $1,000,000 to the Pacific Mutual Life Insurance Co. and $3,000,000 to the Mutual Life Insurance Company.

The agreements and the notes are by their terms interdependent. The agreements provide for the issuance of two promissory notes in the aggregate principal amount of $4,000,000, to bear interest at 3¼% per annum, to be dated February 1, 1949, and to mature February 1, 1964. The terms and provisions of the notes are set out in Exhibit A to the agreements. Each agreement specifies that the plaintiff agrees to sell and the insurance company agrees to purchase the note from the plaintiff at a specified time. Each agreement contains representations by the plaintiff, consisting of the delivery of balance sheets to the insurance companies, a brief description of the business and properties of the plaintiff, a list of corporations of which the plaintiff owns a substantial percentage of stock, etc. Each agreement specifies that it is made by the plaintiff in reliance upon the representation that the insurance company is acquiring the note for its own account and not with the view to, or

for sale in connection with the distribution thereof; "and that you have no present intention of selling or distributing said note * * *."

The plaintiff also agreed that so long as the purchaser holds one or more of the notes and the aggregate principal thereof is $300,000 or more, the plaintiff will, as soon as reasonably possible, after the receipt of a written request, execute and deliver "a trust indenture" and that such indenture shall be delivered to a bank or trust company selected by the plaintiff having a combined capital and surplus of not less than $3,000,000. The agreement further provides that after the execution of the new indenture, upon surrender of the note or notes by the purchaser, the plaintiff will deliver in exchange therefor new notes in an aggregate principal amount equal to the unpaid principal amount of the note or notes so surrendered, either in registered form without coupons or in coupon form and in printed or engraved form. The agreement contains sinking fund and prepayment provisions, optional sinking fund payments and optional prepayments. The agreement requires financial statements. It contains restrictions as to the creation of liabilities, declaration of dividends or the retirement of the plaintiff's stock or any deposition of its assets.

On October 24, 1950, the plaintiff paid to the defendant $4,400 as a documentary stamp tax on account of the issuance of said notes.

On March 29, 1951, plaintiff filed a claim for the refund of the amount of $4,400, which was rejected

by the Commissioner of Internal Revenue on July 20, 1951. This action was commenced September 12, 1951.

/s/ CHAUNCEY F. TRAMUTOLO,
United States Attorney.

/s/ CHARLES ELMER COLLETT,
Assistant United States
Attorney.

[Endorsed]: Filed February 17, 1953.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled cause, having come on regularly for trial on the 24th day of November, 1952, and the Court having duly considered the evidence and being fully advised in the premises, now finds the following:

Findings of Fact

I.

That plaintiff is now and at all times herein mentioned was a corporation organized and existing under and by virtue of the laws of the State of Delaware, and duly qualified to do and doing business in the State of California, with its principal place of business located in the City and County of San Francisco of said state.

II.

That prior to February 1, 1949, plaintiff carried on negotiations with the Pacific Mutual Life Insurance Co. and Mutual Life Insurance Company of New York seeking a loan from said two insurance companies; that no person or persons not employed by or a director of one of said three corporations participated in said negotiations; that said negotiations resulted in agreement as to the terms of a loan agreement with each of said insurance companies together with the terms of a promissory note to evidence each of said loans; that said terms were reduced to writing by said lenders for execution; that under date of February 1, 1949, plaintiff did enter into a loan agreement as so prepared with the Pacific Mutual Life Insurance Co. providing for a loan of $1,000,000.00 to plaintiff, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of $3,000,000.00 to plaintiff; that said agreements were collaterally executed specifically for the purpose of safeguarding and insuring payments of the loans by the borrower to the lenders; that said agreements were not the kind of collateral or trust agreements traditionally used as the foundation or basis for the issuance of corporate obligations or securities; that on or about February 15, 1949, and pursuant to said agreements plaintiff did execute and deliver to said Pacific Mutual Life Insurance Co. and Mutual Life Insurance Company of New York all documents required by said loan agreements, including its two promissory notes dated on the face thereof Feb-

ruary 1, 1949, in the amounts of $1,000,000.00 and $3,000,000.00, respectively; that said notes are not engraved, are not issued in registered form and do not have nor have they had coupons attached; that said two promissory notes are what they purport to be, namely, obligations to repay the two insurance companies the money the plaintiff borrowed from them, and do not have the characteristics that would make them debentures as said term is commonly defined.

III.

That on or about the 24th day of October, 1950, plaintiff received from the Collector of Internal Revenue of San Francisco, California, a notice and demand for tax, wherein and whereby demand was made upon plaintiff that it pay the sum of $4,400.00 as stamp taxes due in connection with the execution and delivery by plaintiff of said two promissory notes in connection with the transactions hereinabove set forth; that as demanded in said notice and demand, and on or about the 24th day of October, 1950, plaintiff did pay to said Collector of Internal Revenue at San Francisco, California, the sum of $4,400.00; that said payment was made solely in order to avoid the penalties threatened to be assessed and asserted against said plaintiff by said Collector.

IV.

That on or about the 29th day of March, 1951, and within two years after the payment of said tax plaintiff did file with the United States Collector of Internal Revenue at San Francisco, California,

a claim for refund of said taxes; that said claim for refund was duly prepared and filed on Form No. 843 furnished for plaintiff by defendant and signed by Sheldon Allen, Treasurer of plaintiff, the claimant therein; that at the time of the execution of said claim for refund said Sheldon Allen was the duly elected and acting Treasurer of plaintiff invested with full power and authority to sign said claim on behalf of plaintiff.

V.

That on or about the 20th day of July, 1951, the Commissioner of Internal Revenue forwarded to plaintiff a letter advising that plaintiff's said claim for refund had been rejected in full; that said notice of rejection from said Commissioner to plaintiff was dated July 20, 1951.

VI.

That no part of said documentary stamp tax paid to defendant by plaintiff on or about the 24th day of October, 1950, in the sum of $4,400.00, has ever been repaid, refunded, or remitted to plaintiff, and no part thereof has been allowed to plaintiff by way of a credit against any other taxes due or claimed to be due from it to defendant.

Conclusions of Law

I.

That this Court has jurisdiction of the subject matter and of the parties.

II.

That the instruments with respect to which the tax here involved was paid are non-negotiable promissory notes.

III.

That said instruments are not bonds, debentures, or certificates of indebtedness, or instruments, however termed, issued by a corporation with interest coupons or in registered form, known generally as corporate securities, as those terms are used in Section 1801 of the Internal Revenue Code, 26 U.S.C.A. §1801, and were and are not subject to stamp tax under that section or any other section of the Internal Revenue Code.

IV.

That the tax, the recovery of which is sought in this action, was wrongfully and illegally collected and plaintiff is entitled to recover said tax in the amount of $4,400.00, together with interest and costs as provided by law.

Let judgment be entered accordingly.

Dated March 2nd, 1953.

/s/ LOUIS E. GOODMAN,
United States District Judge.

[Endorsed]: Filed March 2, 1953.

In the United States District Court for the Northern District of California, Southern Division

Civil Action No. 30871

LESLIE SALT CO.,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

The above-entitled action came on for trial before the Court without a jury on November 24, 1952, the plaintiff appearing by one of its attorneys, Bruce M. Casey, Jr., and the defendant appearing by one of its attorneys, John G. Doll, Assistant United States Attorney, and evidence both oral and documentary having been received and briefs having been filed by both parties, and the Court having filed its findings of fact, conclusions of law, and order for judgment, and its memorandum decision; it is hereby

Ordered and Adjudged that the plaintiff Leslie Salt Co., a Delaware corporation, have judgment against the defendant in the sum of Four Thousand Four Hundred Dollars ($4,400.00) together with interest from the 24th day of October, 1950, as required by law, and for its costs and disbursements in this action, to be hereinafter taxed, on

notice, and hereinafter inserted by the Clerk of this Court in the sum of $15.00.

Dated this 2nd day of March, 1953.

/s/ LOUIS GOODMAN,
U. S. District Judge.

Approved as to form as provided in Rule 5 (d).

/s/ CHARLES ELMER COLLETT,
Assistant U. S. Attorney.

[Endorsed]: Filed March 2, 1953.
Entered March 3, 1953.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that the United States of America, the above-named defendant, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on March 2, 1953.

Dated April 30, 1953.

/s/ LLOYD H. BURKE,
United States Attorney;

By /s/ CHARLES ELMER COLLETT,
Assistant United States Attorney.

[Endorsed]: Filed April 30, 1953.

[Title of District Court and Cause.]

STATEMENT OF POINTS UPON WHICH DEFENDANT (AS APPELLANT) INTENDS TO RELY ON APPEAL

The defendant, upon its appeal from the judgment entered in the above-entitled cause on March 2, 1953, intends to rely upon the following points:

1. The Court erred by holding that the instruments involved are not debentures or certificates of indebtedness, known generally as corporate securities.

2. The Court erred by holding that the instruments were not taxable under Sections 1800 and 1801 of the Internal Revenue Code.

3. The Court erred by having judgment entered for the plaintiff.

LLOYD H. BURKE,
United States Attorney;

By /s/ CHARLES ELMER COLLETT,
Assistant United States Attorney.

[Endorsed]: Filed April 30, 1953.

[Title of District Court and Cause.]

ORDER EXTENDING TIME TO DOCKET APPEAL AND FILE RECORD

The defendant above named, having on the 30th day of April, 1953, filed a Notice of Appeal to the Court of Appeals from the final judgment entered in the above action on the 2nd day of March, 1953, and good cause appearing therefor,

It Is Hereby Ordered that the defendant-appellant may have to and including the 7th day of July, 1953, to docket the appeal and file the record on appeal herein in the United States Court of Appeals for the Ninth Circuit.

Dated June 8th, 1953.

/s/ LOUIS GOODMAN,
United States District Judge.

[Endorsed]: Filed June 9, 1953.

The United States District Court, Northern District of California, Southern Division

No. 30871

LESLIE SALT CO.,

Plaintiff-Appellee,

vs.

UNITED STATES OF AMERICA,

Defendant-Appellant.

Before: Hon. Louis E. Goodman, Judge.

REPORTER'S TRANSCRIPT

Appearances:

For the Plaintiff:

CHICKERING & GREGORY, by
BRUCE M. CASEY, JR.

For the Defendant:

CHAUNCEY TRAMUTOLO, ESQ.,
United States Attorney, by
JOHN G. DOLL, ESQ.,
Assistant U. S. Attorney.

Monday, November 24, 1952—10:00 A.M.

The Clerk: Leslie Salt Company vs. United States. Will counsel please state their appearance for the record?

Mr. Casey: Bruce M. Casey, Jr.

Mr. Doll: John G. Doll.

The Clerk: Thank you, counsel.

Mr. Casey: Your Honor, I would like to make a short statement as to what the issues are, as I understand them, and what facts we intend to prove. This is a suit for refund of Federal stamp taxes paid under protest on two instruments, purporting on their face to be only promissory notes.

The Treasury asserted a tax was due under the statute appearing at 26 U.S.C.A., Section 1801. This Section specifies certain instruments which are supposed to be subject to tax, and insomuch as it is material it provides that the tax apply, quoting from the statute:

> "On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities * * *."

After the tax was paid, Leslie Salt Co. filed a claim for refund, and the claim for refund was rejected. In rejecting [2*] Leslie's claim, the Government did not take the position that the instruments in question were bonds or that they were certificates of indebtedness, or that they bore interest coupons or were in registered form, but it did take the position they were debentures, the grounds being that the terms and circumstances under which the instruments were sold represented a type of financing similar to that accomplished by a debenture which represents financing through the medium of a public issuance of investment securities under an indenture.

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*Page numbering appearing at top of page of original Reporter's Transcript of Record.

That being so, we, of course, plan to prove that the terms of these instruments are not those similar to the terms customarily appearing in debentures. We also plan to prove that the conditions and circumstances under which they were sold also bear no resemblance to the conditions and circumstances under which debentures were sold. We are going to call one witness from the Company who will state precisely what the terms and conditions were in this particular sale. We also have an expert witness who is familiar with debenture financing and is also familiar with the private placement of loans of this type, and he will explain what those conditions and circumstances customarily are. Also explain what terms are customarily found in a debenture issue.

Mr. Doll and I have gone over this case together and there are certain factual statements that are admitted on the pleadings which I want to read into the record. I would like to say [3] in passing that this case is one of first impression in this Circuit. Four cases have reached the Court of Appeals of other Circuits; two of them have gone to the taxpayer and two against.

Mr. Doll and I would both like to submit briefs. I would like permission of the Court to file my memorandum a week from today. I would also like 10 days to answer any memorandum that they want to submit.

You have an opening statement?

Mr. Doll: No.

Mr. Casey: Might as well explain and get these

facts clear that are not disputed in the pleadings. I would appreciate your checking, Mr. Doll.

It is admitted that Leslie Salt Co., plaintiff above named, is now and at all times mentioned was a corporation created, organized and existing under and by virtue of the laws of the State of Delaware, duly qualified to do and doing business in the State of California, with its principal place of business located in the City and County of San Francisco of said State.

It is also admitted that plaintiff seeks to recover from defendant the sum of $4,400.00, together with legal interest thereon from October 24, 1950; that said sum of $4,400.00 represents the net amount of United States Internal Revenue Documentary Stamp Taxes paid by plaintiff on or about the 24th day of October, 1950.

Is also admitted that on or about the 24th day of October, [4] 1950, plaintiff received from the Collector of Internal Revenue in San Francisco, California, a notice and demand for tax, wherein and whereby demand was made upon plaintiff that it pay the sum of $4,400.00 as stamp taxes due in connection with the execution and delivery by plaintiff of two promissory notes in connection with the transactions hereinafter set forth; that as demanded in said notice and demand, and on or about the 24th day of October, 1950, plaintiff did pay to said Collector of Internal Revenue at San Francisco, California, the sum of $4,400.00, that said payment was made solely in order to avoid the

penalties threatened to be assessed and asserted against said plaintiff by said Collector.

Also admitted that on or about the 29th day of March, 1951, and within two years after the payment of said tax, as in Paragraph 4 above alleged, plaintiff did file with the United States Collector of Internal Revenue at San Francisco, California, a claim for refund of said taxes illegally demanded and collected as aforesaid.

And it is admitted that a true and correct copy of said claim for refund is attached in the complaint and that said claim for refund was duly prepared and filed on Form No. 843 furnished to plaintiff by defendant and signed by Sheldon Allen, Treasurer of the plaintiff, the claimant therein; that at the time of the execution of said claim for refund, said Sheldon Allen was the duly elected and acting treasurer of [5] plaintiff, invested with full power and authority to sign said claim on behalf of plaintiff.

Also admitted that on or about the 20th day of July, 1951, the Commissioner of Internal Revenue forwarded to plaintiff a letter advising that plaintiff's said claim for refund had been rejected in full; that said notice of rejection from said Commissioner to plaintiff July 20, 1951.

Also admitted that no part of said documentary stamp tax paid by plaintiff on or about the 24th day of October, 1950, in the sum of $4,400.00, has ever been repaid, refunded or remitted to plaintiff, and no part thereof has been allowed to plaintiff

by way of a credit against any other taxes due or claimed to be due from it to defendant.

It is also admitted that under date of February 1, 1949, plaintiff did enter into a loan agreement with the Pacific Mutual Life Insurance Company providing for a loan of $1,000,000 to plaintiff, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of $3,000,000 to plaintiff; that on or about February 15, 1949, and pursuant to said agreement, plaintiff did execute and deliver to said Pacific Mutual Life Insurance Company and Mutual Life Insurance Company of New York its promissory notes dated on the face thereof, February 1, 1949, in the amounts of $1,000,000 and $3,000,000, respectively.

I guess that is all that is admitted. That's all of the [6] admissions obtained in the pleadings.

Mr. Doll has been furnished with copies of the two promissory notes and also with copies of the loan agreements accompanying the notes, and two certificates which also accompanied the loan agreements. We are going, I believe, to stipulate copies may go in rather than the originals.

Mr. Doll: Yes, we will so stipulate, your Honor.

Mr. Casey: Your Honor will note on reading the loan agreements that it calls for various exhibits to be furnished by the Company. The substance of what those exhibits contain appears in the loan agreements. I thought that it would be just accumulative if I put in the exhibits themselves; it would just add to the documents that will be before the Court.

Can it be stipulated, however, that these exhibits were furnished as called for by the loan agreement?

Mr. Doll: Furnished whom?

Mr. Casey: Furnished by the borrower to the lenders.

Mr. Doll: Yes, we will so stipulate.

Mr. Casey: I would like to offer these documents in evidence. First is a document purported on its face to be a $3,000,000 promissory note executed by Leslie Salt Co. and payable to the Mutual Life Insurance Company of New York.

The Clerk: Plaintiff's Exhibit 1 introduced and filed into evidence.

> (Whereupon promissory note referred to above was admitted [7] into evidence and marked Plaintiff's Exhibit No. 1.)

Mr. Casey: The second document purports to be a certificate of Leslie Salt Co. dated February 1, 1949.

The Clerk: Plaintiff's Exhibit 2 introduced and filed into evidence.

> (Whereupon certificate referred to was admitted in evidence and marked Plaintiff's Exhibit No. 2.)

Mr. Casey: The third purports to be a loan agreement between the Mutual Life Insurance Company of New York and Leslie Salt Company under date of February 1, 1949.

The Clerk: Plaintiff's Exhibit 3 introduced and filed into evidence.

(Whereupon loan agreement referred to above was admitted in evidence and marked Plaintiff's Exhibit No. 3.)

Mr. Casey: The next document purports on its face to be a $1,000,000 promissory note payable to Pacific Mutual Life Insurance Company, and executed by Leslie Salt Co.

The Clerk: Plaintiff's Exhibit 4 introduced and filed into evidence.

(Whereupon promissory note referred to above was admitted in evidence and marked Plaintiff's Exhibit No. 4.)

Mr. Casey: The next document purports to be a certificate of Leslie Salt Co. which applies to the Pacific Mutual Life Insurance Company, and it is dated February 1, 1949.

The Clerk: Plaintiff's Exhibit 5 introduced and filed [8] into evidence.

(Whereupon certificate referred to above was admitted into evidence and marked Plaintiff's Exhibit No. 5.)

Mr. Casey: And the last document purports to be a loan agreement between the Pacific Mutual Life Insurance Company and Leslie Salt Co. under date February 1, 1949.

The Clerk: Plaintiff's Exhibit 6 introduced and filed into evidence.

(Whereupon agreement referred to above was admitted into evidence and marked Plaintiff's Exhibit No. 6.)

Mr. Casey: Mr. Allen, will you take the stand?

SHELDON ALLEN

called as a witness on behalf of the plaintiff; sworn.

The Clerk: Please state your full name to the Court.

The Witness: Sheldon Allen.

Direct Examination

By Mr. Casey:

Q. Where are you employed, Mr. Allen?

A. Employed by Leslie Salt Company.

Q. And what is your position with that company? A. I am Secretary and Treasurer.

Q. Are you familiar with the six documents, the originals of the six documents that have been just received in evidence? A. I am. [9]

Q. Does your signature appear on those documents? A. It does.

Q. Are you familiar with the negotiations and decisions which led up to the execution of those documents? A. I am.

Q. When did the plaintiff in this case, Leslie Salt Co., first decide to borrow the money that is evidenced by the documents that have been received in evidence?

A. It was decided to borrow the money, or the decision was made approximately October 1, 1948.

Q. At that time, was there any discussion as to borrowing from a bank or to issue bonds rather than to borrow from any insurance company?

A. At that time we had outstanding $2,000,000 of revolving credit, bank loans, and of course the

(Testimony of Sheldon Allen.)

matter of extending and increasing the amount of those loans was discussed, and the possibility of issuing annuity securities, such as convertible preferred stock was also discussed.

Q. Why didn't the bank—rather the plaintiff—borrow from the bank and also why did it decide not to issue bonds or preferred stock?

A. Well, of course——

Mr. Doll: I must object to that, your Honor. I don't believe that is particularly material.

Mr. Casey: Your Honor, please, as I stated earlier, the [10] Treasury took the position that the condition and circumstances surrounding the execution of these two promissory notes showed that they were not of mere promissory notes, but were also similar to a type of financing represented by the public issuance of debentures. That being their position, I certainly think, to meet the burden of proof, it is up to me to show what exactly were the conditions and circumstances surrounding the execution of the documents, and I can't confine myself just to the documents themselves. That is the materiality of this line of questioning to the witness right now.

The Court: But counsel, isn't the only question what they did rather than what they talked about? When you speak of facts and circumstances surrounding the transaction, doesn't that just connote the circumstances that comprised the facts, rather than——

Mr. Casey: Your Honor, I think it is not only

(Testimony of Sheldon Allen.)

what they did, but why they did it, that is material.

The Court: Yes, if that is the Government's position, I would be inclined to hold against them, because I don't think it makes any difference why they did it.

Mr. Doll: That is our position.

The Court: I suppose that they must have needed the money, that is obvious; they wanted to get some money, so decided to go through with this procedure. What is the materiality of the mental processes as expressed in conversations or the [11] decisions among themselves; what has that to do with it?

Mr. Casey: Well, I think, your Honor, when a company is making a decision to borrow money there are certain circumstances which affect that decision which have a materiality.

The Court: I can understand that, but I would think that would be developed necessarily by the discussions; they probably considered the cost and expenses——

Mr. Casey: Precisely.

The Court: ——the problems that go into financing, but that wouldn't necessarily be shown by what the conversations were, that is all. The witness could be examined; and another witness could testify as to what are the costs and expenses involved in the different types of financing; the Court could draw its own conclusion that ordinarily American businessmen are prudent and they follow a course that is least expensive, if they could get the money

(Testimony of Sheldon Allen.)

that way. I think that is all that is involved in that.

I will sustain the objection on the ground that it calls for hearsay discussions.

Q. (By Mr. Casey): In any event, you did decide to borrow from the two insurance companies?

A. That's correct.

Q. Was this a unique transaction on their part, or are they in the business of making commercial loans to manufacturers of this type? [12]

A. I am unable to state whether they are in the business. I know that they do make loans to other commercial manufacturers.

Q. Who made the first approach as between insurance companies and Leslie Salt Company with respect to execution of the loans?

A. The loan contact was made by one of our directors, Mr. Jasper W. Tulley.

Q. Were the services of an investment banker employed as an agent in the negotiations, or were all negotiations carried out directly between the company that borrowed and the insurance companies?

A. The negotiations were carried on direct by the company and the representative of the lender.

Q. Did you negotiate with any other insurance companies with respect to these two loans?

A. No.

Q. Who prepared and presented the first document or letter presenting the proposed terms of the loan?

A. An employee of the insurance company. The

(Testimony of Sheldon Allen.)

one, New York Mutual Life Insurance Company of New York, prepared a memorandum early in December, 1948, outlining in general the terms of the loan agreement.

Q. Were there any subsequent directives or documents prepared prior to the final execution of the instruments——

A. Yes, they printed up a form of note, form of certificate, form of loan agreement, sent them to us in the form of proofs. [13] Actually, numerous changes were made before the final papers were drawn.

Q. In other words, they were taking the affirmative and preparing terms, they would present the terms to you and then you would discuss them after they had submitted their first proof?

A. That's right.

Q. Where were the loans closed?

A. At our office in San Francisco.

Q. I suppose there was the usual exchange of documents at that time? A. That's right.

Mr. Casey: I believe that is all I have, Mr. Doll.

Mr. Doll: No questions.

The Court: That is all.

(Witness excused.)

Mr. Casey: Mr. Beckett, will you take the stand?

JOHN R. BECKETT

called as a witness on behalf of the plaintiff. Sworn.

The Clerk: Please state your full name to the Court.

The Witness: John R. Beckett.

Direct Examination

By Mr. Casey:

Mr. Beckett, will you please state your [14] educational background?

A. I received my A.B. from Stanford University in 1939 and an M.A. from that institution in 1940, majoring in both instances in finance and economics.

Q. What has been your business experience since your graduation?

A. Upon receiving my M.A. degree I was employed by the Pacific Gas and Electric Company to do financial studies in conjunction with the Sacramento Condemnation Case which was then in progress.

In 1941 I moved to Chicago with a firm called Duff and Phillips, which firm specialized in financial studies concerning utilities for the larger financial institutions across the country, such as insurance companies and banks.

In 1942 I went with the Securities and Exchange Commission as financial analyst expert.

In 1943 I was employed by the Seattle Gas Company as assistant to the president, primarily in charge of that company's financial matters and af-

(Testimony of John R. Beckett.)

fairs, and in 1944 I went with Blyth and Company in ~~New York~~.

Since 1944 I have been employed with Blyth and Company in conjunction with their new issue business, the buying department. I have traveled extensively for Blyth and Company as a financial expert and I have had the sole responsibility for technical work for Blyth and Company for issues of securities [15] which in the aggregate come to many hundreds of millions of dollars.

I am past president of the Securities Analysts of San Francisco and past vice-president and director of the National Association of Financial Analysts Society.

Q. For the purpose of the record, Mr. Beckett, what business is Blyth and Company engaged in?

A. Blyth and Company are primarily underwriters of securities.

Q. They have offices in addition to their office here in San Francisco?

A. We have 28 offices throughout the United States, and are one of the major factors in the business.

Q. Mr. Beckett, have you done work in conjunction with the public sa[illegible] debentures and the private sale of notes to financial institutions?

A. I have worked on bond debentures which have been sold to the public and on private placements of notes with insurance companies. And in the latter connection, I have prepared for our company a number of studies, including one study

(Testimony of John R. Beckett.)

which we issue to the public nationwide, the service to banks and insurance companies, and also to companies considering private placement transactions.

Q. Based upon your experience and based on your understanding of the terms debentures and notes, as those terms are used in business and financial circles, will you please describe the [16] differences in terms between debentures and notes?

Mr. Doll: Your Honor please, I must object to this line of questioning, because the facts here are uncontradicted as to the agreements, as to the notes, and we feel that the Court should not resort to extrinsic evidence on a stamp tax controversy to change the face of the instrument. That is, the Government contends that these notes are subject to tax and in making that decision we should rely simply on the notes themselves, on the agreements and on the circumstances surrounding that. And evidence such as that attempted to be introduced now is superfluous.

I want to call to the Court's attention the case of Motter vs. Bankers Mortgage Co. of Topeka, Kansas, 93 Fed. 2d 778. The Court stated on Page 780:

> "Whether obligations are corporate securities within the meaning of the statute is a mixed question of fact and law to be determined by the provisions in the instruments themselves, face and form of the certificate or bond, and the circumstances under which they were issued. When facts are thus ascer-

(Testimony of John R. Beckett.)

> tained, then it becomes a question of law as to whether they are corporate securities within the terms of the statute. The Court of Claims——"

in Fidelity Investment Association vs. the United States, 5 Fed. Suppl. 19, [17]

> "——declared that the nature and character of an instrument, doubtful in characteristics and appearance is a question of fact and approved the admission of expert testimony bearing thereon, but where the instrument is plainly and patently on its face a secured indebtedness, oral evidence would be superfluous. These instruments are plainly and patently secured obligations, conditional and contingent in nature. Expert testimony as to how they are commonly denominated and regarded by those engaged in the purchase and sale of securities, being entirely superfluous, had no proper place for consideration in the trial below."

I also want to cite United States vs. Isham, 17 Wallace 496. The Court said on Page 505:

> "It is not permissible to the Courts nor is it required of individuals who use the instrument in their business, to inquire beyond the face of the paper. Whatever upon its face it purports to be, that it is for the purpose of ascertaining the stamp duty."

And therefore, your Honor, I feel that any testi-

(Testimony of John R. Beckett.)

mony along these lines is superfluous and inadmissible.

The Court: What does the statute say? Have you got that handy?

Mr. Doll: Yes, your Honor. It is Section 1801 of Title 26. [18]

The Court (Reading to himself): Well, if there is a question as to whether or not a document is known generally as a corporate security, wouldn't that become an issue of fact?

Mr. Doll: Well, I believe—our position, your Honor, is that there is no question as to the interpretation of the agreements and of the notes. They are clear, they are inadmissible, and then there is a legal question as to whether or not those notes are debentures within the meaning of the Act.

The Court: You mean that the Court would have to preliminarily determine whether or not the documents needed interpretation as securities as generally known, that if it first is decided that that interpretation is made, then there isn't any question of fact to be determined?

Mr. Doll: Yes, your Honor, that is our position. And in this case, as I understand it, there is no ambiguity in the instruments, there is no question as to what they mean; then it is a question of law as to whether or not those notes are debentures within the meaning of the Act, and we ~~would then~~ rely on the cases that have already been decided in interpreting the term debentures within the meaning of that section.

(Testimony of John R. Beckett.)

The Court: If they are debentures, then there is no need, you say, for any other evidence. Is that what you mean?

Mr. Doll: That is right.

The Court: If they are debentures.

Mr. Doll: Yes, your Honor. [19]

The Court: If that is the question, it becomes necessary to determine whether they are generally regarded as securities; then it would be proper for the Court to hear that evidence.

Mr. Doll: Well, I think it is not a question as to whether or not these agreements are generally regarded as debentures or securities, by security analysts; it is not a question of that at all. In fact, it is a question as to whether or not they are debentures within the meaning of that legal term.

The Court: No, maybe I didn't make myself clear. I notice that the statute refers to classes of documents.

Mr. Doll: Yes.

The Court: It says there should be a tax on all bonds and debentures and on securities of indebtedness. Then it goes on and says on all instruments however termed, issued by a corporation with interest coupons or in registered form, known generally as corporate securities. So that if an instrument is a bond or a debenture or certificate of indebtedness it is your contention that, and that is so termed, there is no further inquiry to be made?

Mr. Doll: That is right, your Honor.

(Testimony of John R. Beckett.)

The Court: But if it is not a bond or a debenture or a certificate of indebtedness there—but it is claimed to be taxable, subject to the stamp tax because it is an instrument that is termed, that is, has coupons attached or in registered form known as a corporate security. [20]

Mr. Doll: It is our contention, your Honor, these instruments are debentures within the meaning of the statute.

The Court: Well, they haven't got any interest coupons and they are not registered, in registered form?

Mr. Doll: Yes.

The Court: On the face of it.

Mr. Doll: That is right.

The Court: No dispute about that.

Mr. Casey: Certainly not.

The Court: So would they have to have those two in issue in order to——

Mr. Doll: No, your Honor.

The Court: ——to be taxed subject to the stamp tax as corporate securities?

Mr. Doll: Yes, in order to be taxed as corporate securities they would have to be in registered form and have coupons attached, but that section has been interpreted as being in the alternative that debentures can be taxed and need not be in registered form or have coupons attached.

The Court: Well, what does the Court have to have before it in order to determine whether the documents are debentures?

(Testimony of John R. Beckett.)

Mr. Casey: That is a point I have in mind, too, your Honor. It seems to me that Mr. Doll is asking us to take judicial notice of what terms customarily appear in a debenture. Incidentally, I have a number of cases I would like to discuss [21] when Mr. Doll is through.

The Court: What is this witness going to testify to, what is the purpose of his testimony? Perhaps I can rule more intelligently if I know what it is.

Mr. Casey: Yes, your Honor.

This witness is going to testify, number one, as to what terms appear in the debenture issue with which he is familiar. He is also going to testify as to the conditions and circumstances under which debenture issues commonly are marketed to the public. Both those points are material, according to the position that the Treasury has taken since 1947. Mr. Doll's cases, you will note from the citations, were all prior to that time. If your Honor please, I would like to quote from a regulation that came out by the Treasury in 1947. Incidentally, I would like to say that in 1947——

The Court: Before you get on to that, what precisely is this witness going to testify to, what is the nature of his testimony going to be? I presume you know that.

Mr. Casey: Yes, your Honor.

The Court: You, no doubt, have talked to him about it.

Mr. Casey: He is going to testify as to the type

(Testimony of John R. Beckett.)

of restrictive relations that appear in a debenture; also going to say debenture issues are commonly sold under an indenture, a trustee being a party to the debenture, and the trustee, of course, being in that position to protect the rights of the [22] debenture holders. He is also going to testify as to the denominations customarily found on debentures.

The Court: Is he going to give a definition of debentures as he understands them, or is that something that has been legally determined?

Mr. Casey: I believe that there is no precise legal definition of the term. In the discussions since 1947 of what is and what is not a debenture primarily reliance has been placed on how they are sold, what happens to them when they are sold. I don't know that you can fix it any more clearly than that. In other words, circumstances would have weight one way or another.

The Court: Well, I suppose there is some difference between a debenture and a promissory note; both, of course, are promises to pay money.

Mr. Casey: Certainly.

The Witness: In a certain sense.

Mr. Casey: They have similarities; they also have differences.

The Court: Well, I think it would probably save time, Mr. Doll, if all this witness' evidence should go in, subject to motion to strike.

Mr. Doll: I would like the record to show——

The Court: The court would be better able to

(Testimony of John R. Beckett.)

rule on these, on your objections, because it probably goes somewhat [23] to the heart of the case anyway.

Mr. Doll: To summarize my objection, your Honor, it is simply that debenture is a legal term and it has been dealt with by the Courts in many cases, and it is not up to the security analysts to tell the Court what debentures are, but the Court should so decide relying on the law in the numerous cases dealing with that term in the past and with the history of the Acts which also affect the term.

The Court: Well, I suppose his testimony is going to be very brief.

Mr. Casey: Certainly is.

The Court: I will allow the testimony to go in subject to a motion to strike, and reserve ruling on it.

Mr. Casey: Your Honor, in view of the fact that this question has come up, though, I would like permission to recall Mr. Allen. I think I would like to put in the letter from the Treasury rejecting our claim for refund so that the grounds of their rejection will appear.

The Court: You don't need to recall him for that. There is no question about the authenticity of the letter.

Mr. Doll: No.

The Court: Just offer it in evidence.

Mr. Casey: I am offering it for the purpose of showing the relevancy of this testimony here.

(Testimony of John R. Beckett.)

The Court: All right, put it in. [24]

Mr. Casey: In view of the motion to strike.

I offer a document purporting to come from the United States Treasury Department under date of July 20, 1951, and addressed to the Leslie Salt Co.

The Court: That is the rejection of the claim?

Mr. Casey: The claim is rejected, stating the grounds.

The Clerk: Plaintiff's Exhibit 7 introduced and filed into evidence.

(Whereupon Rejection of Claim Letter referred to above was admitted in evidence and marked Plaintiff's Exhibit No. 7.)

Q. (By Mr. Casey): Mr. Beckett, I believe that we had gotten to the point where I had asked you to describe the difference in the terms customarily appearing in instruments purporting to be debentures as contrasted with instruments purporting to be notes, as those terms are understood in business and financial circles?

A. Both debentures and notes are unsecured promissory payments to pay. But in the case of a debenture, an indenture is prepared in connection with the issue, which indenture contains a number of protective provisions. Provision is likewise made for an independent trustee to see to it that the terms of the indenture are fulfilled. Restrictive terms contained in a debenture issue are usually less severe than those contained in notes sold to private buyers.

(Testimony of John R. Beckett.)

On the other hand, while notes sold privately to a private [25] buyer or a group of buyers contain protective features, no trustee is created, since none is needed, as a note issue is not widely held or traded in. Protective features for notes sold privately are usually less severe—are usually more severe than for debentures sold publicly.

As to the mechanics——

Mr. Doll: The witness is reading from some notes; might I take a look at those?

Mr. Casey: Certainly.

The Witness: You certainly can.

Mr. Doll: Were these prepared by yourself for use at this trial?

The Witness: They were prepared by myself for use at this trial.

Q. (By Mr. Casey): Mr. Beckett, will you please describe the mechanics of the sale of debentures and of the sale of notes?

A. Debentures are usually sold to the public by public offerings. These are to be offered through the channels of investment bankers and investment banking groups and investment dealers. In other words, there are usually many individuals and houses interested in the offering to the public, which offering is usually made in units of $1,000 pieces of paper, or in multiples thereof.

Incidentally, one reason for the necessity of a trustee in the case of debenture is to protect the many holders [26] resultant from public sale. On the other hand, notes sold privately to insitutions

(Testimony of John R. Beckett.)

have most of the characteristics of a loan made with a bank and the investment banking channels are not required. Sometimes the investment banker is used in the sale of privately placed notes, but then he is only employed as a financial agent. He does not use his capital or his distribution facilities. Notes sold privately are not usually sold in units of $1,000, and as I have mentioned, there are no trustees.

Many issues placed privately do not employ the system of investment bankers, which is in direct contrast to the public sale of debentures, in that the issuer and the borrower negotiate the agreement without the services of the investment banker, even as a financial agent. It is my understanding this was the case in conjunction with the note issue currently under consideration.

While discussing this phase of the subject, it might be interesting to point out that a note placed privately with an insurance company or a bank loan are each covered by agreements setting forth certain restrictions on the issuer, setting up the rights of the buyer and providing for repayment of the credit, and the only fundamental difference between a bank loan and an insurance company note seems to lie in the fact that the insurance companies are in a position to extend longer maturities than can a commercial bank. It might be that the [27] factor of similarity between an insurance note and a bank note will be of aid in distinguishing the private placement from the bond or debenture.

Q. (By Mr. Casey): Mr. Beckett, you said in-

(Testimony of John R. Beckett.)

surance companies are usually in a position to extend credit over longer periods than are commercial banks. Is that invariably the case, or do sometimes commercial banks extend credit for say 10 to 15 years?

A. To my knowledge there has been no commercial bank extending credit up to 15 years, in recent years. Some of the commercial banks will ~~make~~ loans from 7 to 9 years, which are about as long a maturity you can get from a commercial bank. They don't like to make a loan of that duration.

Insurance companies usually pick up where the banks leave off, and will make loans of a duration from 9 to 25 years, or even up to a hundred years.

Also an insurance note and a bank note are made a part of the same transaction, the banks taking an early maturity, let's say, the first five years, and the insurance company the next ten maturities, or the next 10 years, let's say, for a 15 year note. That is a very common practice, where the banks take early maturities, insurance companies take the later maturities. On such a note issue the restrictive provisions securing that note issue are identical for the bank and the insurance company.

Q. Will you describe how restrictive provisions are [28] negotiated for debentures and notes?

The Court: I don't see any point to how they are negotiated; what has that got to do with it? Again it is what is done that counts. That involves a long discussion.

Mr. Casey: Yes, your Honor.

(Testimony of John R. Beckett.)

The Court: Operating, financing, and so forth. I don't see that helps this case.

Mr. Casey: The point I was going to bring out, your Honor, is that insofar as the provisions that appear in the loan agreement that has been introduced in evidence, that was the result of direct negotiations between the buyer and seller.

The Court: That would be true in any agreement in connection with any financing.

Mr. Casey: No, your Honor, I don't believe that is the case. If I go out into the market and——

The Court: Somebody has to negotiate an agreement if they are debentures or what they are. What difference does that make?

Mr. Casey: I would like to be heard a moment more on that. If I buy a debenture on the market, I don't negotiate at all; the terms are already set up.

The Court: I understood you to say that you were talking about the negotiations leading up to the establishment of the documents, the making of the documents on which debentures are issued. Somebody has to negotiate the transaction. I assumed [29] that is what you are referring to.

Mr. Casey: Somebody has to negotiate the terms in a private placement of a note, no question about that.

The Court: They have to negotiate the terms in a public placement, too, somebody has to devise the instrument.

Mr. Casey: That is right.

The Court: On which the debentures are issued.

(Testimony of John R. Beckett.)

Mr. Casey: You are quite correct. But I meant there was no negotiations between seller and borrower; the terms are already fixed before the borrower makes up his mind to lend the money or refuse to lend the money. In other words, his choice is to buy or sell, he doesn't have any choice insofar as changing provisions in the agreement.

The Court: Nothing to stop the insurance company here if it wanted to issue its own obligations or an interest in a note which it had, the insurance company could issue or sell fractional interests in this, couldn't it, provided it complied with all the regulations of the State or Federal Government in that regard?

Mr. Casey: The insurance company could assign.

The Court: If they did that, then what it issued would probably be called debentures, without any question.

Mr. Casey: If your Honor has read that Company agreement you will find that there is a provision for the creation of the, or the substitutions of debentures. If the borrower wanted [30] to—If the insurance companies wanted to, they could have insisted at a later time that a new provision come into effect which involved the creation of the debenture.

The Court: Well, the insurance company had an agreement which contained many provisions with respect to governing the relationship between the borrower and the lender. And now, there would be nothing to stop the insurance company from dis-

(Testimony of John R. Beckett.)

posing of its interest as the lender in the form of notes which it might sell, provided it complied with the applicable Federal or State regulations.

Mr. Casey: That is right, there would be nothing to stop it, but I think it would certainly be a different situation that occurs when you have an issuance of debentures that are offered to the public.

The Court: Well, they are capable of being offered to the public by the insurance companies.

Mr. Casey: It can't offer these two notes.

The Court: Well, divide it up.

Mr. Casey: Well, I think the—entirely new documents would have to be executed.

The Court: That is right.

Mr. Casey: Before it could do so. That seems to me to be a significant difference.

The Court: Well, if it could do that, then why wouldn't the issue—why wouldn't the one note be a debenture then? [31]

Mr. Casey: Why wouldn't the one note be a debenture?

The Court: Yes.

Mr. Casey: Because Mr. Beckett, as you recall, your Honor, said that when a debenture is issued it is accompanied by an indenture to which a trustee is a party. There is no such document in connection with this note as far as——

The Court: You say it is essential that before an obligation shall be called a debenture there has to be a trustee?

Mr. Casey: I will make the contention, yes, your

(Testimony of John R. Beckett.)

Honor, I certainly will; I think that is the fact that all debentures——

The Court: Couldn't there be other means of enforcing the terms made without the necessity of having a trustee?

Mr. Casey: Well; in this note here the lender is the one who is going to enforce his provisions, no need for a trustee here, because we have no wide market where there are several lenders involved rather than just two. If I sell to the public naturally a trustee is going to be needed and the public is in no position to protect itself.

The Court: I guess we are getting a little far off in the argument here. The question that has been asked, I don't quite see the materiality of the question of the negotiations concerning the matter.

Mr. Casey: Perhaps, your Honor, I should have done this before, cited a couple of cases. [32]

The Court: Never mind about that, let's get the record completed and then make all the argument that you consider necessary.

Ask another question, or reframe it so we can move along with the testimony.

Mr. Casey: I didn't understand, your Honor.

The Court: I say, would you mind either repeating that question or asking another question?

Mr. Casey: All right.

Q. (By Mr. Casey): Mr. Beckett, will you describe how restrictive provisions are created for debentures and notes?

A. In the case of debentures, the terms of the

(Testimony of John R. Beckett.)

indenture are created by the negotiations of the issuer and the buying investment banker. Or, in the case of a competitive bid for debentures solely by the issuer. When debentures are offered to the public the terms are fixed and the buyers of the debentures either buy or refuse to buy based on the terms of the issue.

On the other hand, notes which are privately placed bear terms fixed by the lender and the borrower by direct negotiation.

Now, one of the terms usually contained in a private note is a provision that the note is being purchased for investment and not for resale. However, in case the purchaser of said note decides that he wishes to resell a portion of said note, provision is usually made so that an indenture will be created and [33] that the note will be broken down into pieces which can be sold to the public, and when such indenture is created and a debenture created and the piece is sold to the public, I would assume at that time that the instrument had changed and had become a debenture and would be taxable.

Q. Mr. Beckett, will you explain the characteristics of after markets for debentures and notes?

A. Since debentures are sold to the public, it is characteristic of a debenture issue that public trading takes place following the initial distribution; and there is a known after market after such initial distribution. Buyers of the debentures, therefore, know from day to day or from week to week what their investment is worth based upon public conditions.

(Testimony of John R. Beckett.)

The issuer of the debentures is likewise in a position to buy said debentures in the open market, often, if interest rates have changed, at a discount from the original issue price.

On the other hand, notes placed privately have no after market and no public trading, and in fact, the buyer of a private note usually warrants in the loan provisions that he is buying such note for investment and not resale. There is no possibility in the case of a private note for the issuer to buy at a discount.

Q. Is it possible to amend restrictive provisions incorporated into debentures and notes?

A. It is possible in each instance, though much more difficult [34] in the case of a debenture, because of the widespread distribution of the instrument as compared with a privately placed note where you can sit down and negotiate the provisions in case of change.

Q. Will you describe the differences in sales methods of debentures sold publicly and notes privately placed?

A. Debentures sold to the public are usually sold by the investment banking profession as above outlined through the use of a circular or prospectus and in fact, a public offering of any size, the prospectus, which is part of the registration statement, is filed with the Security and Exchange Commission.

One of the characteristics of the debenture is that considerable time and expense is taken in preparing it for public offering, including the preparation of the registration statement.

(Testimony of John R. Beckett.)

In contrast, notes sold privately are not sold by means of prospectus or circular, and to my knowledge no notes have ever been sold privately which have been registered with the Securities and Exchange Commission.

The private sale of a note can be accomplished much more quickly than a public sale of a debenture, and a much more easier transaction to accomplish, and this is one of the advantages of the private sale.

Of course, the disadvantage of the private note sale as compared with the public sale of debentures is that a company's [35] credit is enhanced publicly by public sale, and the name of the seller becomes better known across the country.

Q. As a matter of practice, Mr. Beckett, do those selling debentures customarily attempt to obtain clearance from State Blue Sky Laws?

A. It is customary to obtain clearance from State Blue Sky Commissions, which is in contrast to the sale of notes privately.

Q. Do those selling debentures customarily attempt to obtain opinion of legal counsel as to the legality of the investment in the issue?

A. Because the debenture sale is offered usually through the several states to a wide buying audience, legal opinions are made and advanced as to whether the instruments are proper investments for financial institutions. This is in contrast to the sale of notes.

Incidentally, on that point, I would like to state

(Testimony of John R. Beckett.)

that while the debentures are occasionally sold privately to insurance companies as debentures, not as notes, so that there have been instances when debentures have been sold privately to insurance companies without the procedures as above-mentioned, but sold as debentures so that resale may be accomplished by the insurance companies without going through the creation of the indenture and these other things which I have talked about.

Q. What is the difference in appearance between a debenture and a private note? [36]

A. Debenture certificates are usually prepared in a form to be negotiable and have the word "debenture" printed on them, or engraved, together with restrictive covenants.

Q. Let me interrupt you. You mean that the restrictive covenants appear on the debenture itself?

A. Very often they appear on the backside of the debenture, much as preferred stock articles appear on the backside of the preferred certificates.

Q. Have you read the loan agreements between Leslie Salt Company and the Mutual Life Insurance Company of New York and the Pacific Mutual?

A. I have examined such agreements.

Q. In your opinion, do the notes, agreements and accompanying notes conform to such standards as to make the issue a debenture issue as that phrase is used in business and financial circles?

The Court: Well, of course, I have great re-

(Testimony of John R. Beckett.)
spect for the opinion of this gentleman in testifying, but I don't think that is the problem.

Mr. Casey: Only accumulative, your Honor. Withdraw the question.

That is all I have from Mr. Beckett.

The Court: Do you want to examine the witness or do you want to make a motion to strike?

Mr. Doll: I would like to make a motion to strike the [37] testimony. I would also like to request of counsel a copy of the notes that were used in connection with Mr. Beckett's testimony.

Mr. Casey: Certainly. I don't have it right now; I will get you one.

The Court: I will reserve ruling on the motion to strike.

Mr. Doll: Yes, your Honor.

The Court: I don't think there is anything particularly about the testimony that is so vital that the case would have— —

Mr. Casey: Certainly the whole thing ought to be briefed together on the motion to strike.

The Court: Is there anything further? Would you like to ask any questions?

Mr. Doll: There are just two brief questions I would like to ask Mr. Beckett.

Cross-Examination

By Mr. Doll:

Q. One is, did you or the Blyth Company have anything to do with the issue of the notes in question? A. No, we did not.

(Testimony of John R. Beckett.)

Q. And you were called in on this just after you were consulted by counsel for the plaintiff, after the notes signed and so on just in connection with this case?

A. Just in connection with this case.

Q. The type of financing that we have in question here, a large sum of money, loaned by insurance companies to a [38] corporation for a relatively long period, is that a well-established type of financing, or is that a method of rather recent origin?

A. It is a method of rather recent origin if you consider the years—1947, I guess is when it became in considerable vogue, if my recollection is right, approximately 18 per cent of the corporate flow in the year 1947, was done through private methods. It is now probably 50 per cent of the corporate flow that is done through private placement. It is a very sizeable portion of the corporate flow.

Mr. Doll: That is all.

The Court: That is all.

Mr. Casey: I would like to ask one more question.

Redirect Examination

By Mr. Casey:

Q. You have examined these two notes and accompanying agreements and state that you are familiar with several other similar type loans. Is there anything unusual about this particular transaction compared to other transactions of the same size between insurance companies?

(Testimony of John R. Beckett.)

A. It is the most usual transaction for the time in which it was made. Provisions change as styles change, and the loan made today will be somewhat different from the loan made in 1949, but it was most usual for the year in which it was made.

Mr. Casey: Thank you very much, Mr. Beckett.

(Witness excused.) [39]

Mr. Casey: Your Honor, if I might have 10 days instead of 7——

The Court: Any other evidence?

Mr. Casey: No, I submit my case.

The Court: Any evidence?

Mr. Doll: No, your Honor, we have no evidence to introduce.

The Court: The matter, I take it, being really submitted on the form of these documents, more than anything else?

Mr. Doll: Yes, your Honor.

The Court: Against the background of the rule that you cited, counsel, two circuit decisions, two one way and two the other way.

Mr. Casey: That is right. This is the first time it has been heard in this Circuit.

The Court: And in all four cases the factual situation is similiar?

Mr. Casey: Similar, yes. There are differences in all four cases as contrasted——

The Court: Are they insurance company cases?

Mr. Casey: Three are insurance company cases, one a bank case. The bank case involved trans-

actions with the same restrictive provisions in the form as we have here. I believe the period was somewhat shorter.

The Court: You say two Circuits decided in favor of the [40] taxpayer and two against him?

Mr. Casey: Yes, your Honor.

The Court: You happen to know what circuits they were?

Mr. Casey: Seven and five were for the taxpayer; the Second Circuit was against the taxpayer, and frankly I have forgotten just what circuit it was, it was also against the taxpayer. The Second Circuit case was the first one that came down, and that was against the taxpayer. It was followed almost immediately by another case that just followed it.

The Court: Certiorari been asked for in any of these cases?

Mr. Casey: Certiorari was asked for by the taxpayer in the first case that came out, the Second Circuit case. Certiorari was denied. That was the first case on this point.

The last case that came up—No, I forget, the next to the last case that came up was in '51. It was for the taxpayer and it was recently announced by the Solicitor General he was not going to seek certiorari in that case.

The Court: He probably is satisfied to try and take his chance on getting some victory without having a final decision by the Supreme Court.

Mr. Casey: I would suspect that is the case, wasn't going to go for certiorari.

The Court: Well, you say you would like to brief this matter?

Mr. Casey: Yes, sir. I would like to have 10 days rather [41] than the 7 I originally asked for. I didn't anticipate we would have this motion to strike pending and that might take a little bit longer.

The Court: I don't think there is very much about the testimony of the witness that would be vital to the case. He has given a general description of the debentures, how they are handled, and it would be most natural to expect that an investment banker would favor that procedure which would most facilitate the business of investment banking so that there wouldn't be the expense to pay. It is purely a legal question, really, isn't it?

Mr. Casey: I would have thought so except for the position that the Treasury took in denying our claim for refund. I don't know whether it was based on misapprehension of some of our facts or what facts they thought regarding the public issuance of security, but certainly did not accept all of our facts.

Mr. Doll: That is not the position taken now by the Government.

The position now is that a debenture should be charged, no ambiguity in it at all, charged simply on its terms and the only way you can administer a revenue measure.

The Court: I would think that probably is so, that we have to decide under this statute whether these particular documents are subject to the stamp

tax, what the congress had in mind in passing this Statute. I think probably it is quite clear that [42] it did not intend to tax these transactions generally regarded as public financing in character, no question about that, and of course, I mean, it didn't intend to tax the ordinary borrowing of money commercially between the borrower and the lender.

Mr. Casey: Yes, your Honor, there was a tax on promissory notes at one time, and it was rescinded and it is no longer in effect.

The Court: It didn't intend to enter the field of general simple borrowing between businessmen and a financial institution or between a businessman and some private person who wanted to lend him some money. Apparently intended not to enter that field, so that I suppose it comes down to a question whether or not this particular type of borrowing, in which a large sum of money is borrowed from financial institutions, such as an insurance company, accompanied by somewhat elaborate arrangements restricting the activities in some respects of the borrower, and it takes it out of the field which Congress didn't intend to enter under this Statute.

I suppose there could be a document that would be a debenture even though there were just one borrower. I mean, just—Yes, if there was just one lender, even if there was one lender, I suppose the document could have all the attributes of what is commonly called debentures.

Mr. Casey: Certainly wouldn't have the same provisions and same terms we do. [43]

The Court: Same general conditions and terms as then would pertain in one of these issues Mr. Beckett spoke about, so that the test probably is not whether or not it is just a single lender, but the test probably is in a general way what Mr. Doll has said as to what the terms and conditions of the transaction are.

Well, could you give me the four Circuit citations now?

Mr. Casey: Yes.

The Court: And I could have a chance to look at them before I receive the briefs; may be helpful in following them.

Mr. Casey: The first one, your Honor, the first one I have here in my notes, Allen vs. Atlanta Metallic Casket Co., 197 Fed. 2d 460.

The Court: Is that for or against the taxpayer?

Mr. Casey: That is for the taxpayer.

The Court: And the other one for the taxpayer?

Mr. Casey: Is Belden Mfg. Co. vs. Ja[illegible]ki. It is reported at 192 Fed. 2d 211. Also for the taxpayer. That case, your Honor, is the one in which the Solicitor General decided not to seek certiorari.

The Court: Ones against the taxpayer?

Mr. Casey: Both of those—No.

The Court: You said those were for.

Mr. Casey: Those were both for.

Mr. Doll: I have them, your Honor. [44]

The Court: Have you got them?

Mr. Doll: General Motors Acceptance Corp. vs. Higgins, 161 Fed. 2d 593. That is in the Second

Circuit. And Commercial Credit Company vs. Hofferburt, 188 Fed. 2d 574. That is in the Fourth Circuit and it affirms 93 Fed. Suppl. 562.

Mr. Casey: The affirmance is merely per curiam, so the opinion is really of the lower Court.

The Court: Opinion of the lower Court. The Government won the first two cases in the Circuit Courts, and then later on the taxpayer won the last two cases, so——

Mr. Doll: I wish to reverse the trend.

The Court: The Courts—197 and 192, must have had the benefit of the contrary decisions.

Mr. Casey: Yes, they are discussed in both opinions.

The Court: Well, you want ten days to file your brief?

Mr. Casey: If I may.

Mr. Doll: Your Honor, I would like to ask for twenty days. I talked to the Department on the phone this morning and they have indicated they would like to write the brief and therefore in order to facilitate that I ask for twenty days.

The Court: And then would like a final ten days to reply?

Mr. Casey: If I may, please.

The Court: All right, then, file briefs in 10, 20.

Mr. Casey: And 10.

The Court: And 10. [45]

The matter may stand submitted on the briefs, then.

Mr. Casey: Yes, your Honor.

Mr. Doll: Thank you, your Honor.

Certificate of Reporter

I, Official Reporter and Official Reporter pro tem, certify that the foregoing transcript of 45 pages is a true and correct transcript of the matter therein contained as reported by me and thereafter reduced to typewriting, to the best of my ability.

/s/ RUSSEL D. NORTON.

[Endorsed]: Filed June 11, 1953. [45-A]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO TRANSCRIPT OF RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, do hereby certify that the foregoing and accompanying documents and exhibits, listed below, are the originals filed in the above-entitled case, and that they constitute the record on appeal as designated by the attorneys for the appellant:

Excerpts from civil docket.

Complaint.

Answer.

Memorandum decision.

Plaintiff's proposed findings of fact and conclusions of law.

Defendant's proposed findings of fact.

Findings of fact and conclusions of law.

Judgment.

Notice of appeal.

Statement of points upon which appellant intends to rely on appeal.

Order extending time to docket appeal and file record.

Designation of record on appeal.

Reporter's transcript for November 24, 1952.

Plaintiff's exhibit 1 to 7.

In Witness Whereof I have hereunto set my hand and affixed the seal of said District Court this 12th day of June, 1953.

[Seal] C. W. CALBREATH,
Clerk.

By /s/ C. M. TAYLOR,
Deputy Clerk.

[Endorsed]: No. 13873. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. Leslie Salt Company, Appellee. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed June 12, 1953.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 13,873

UNITED STATES OF AMERICA,

Appellant,

vs.

LESLIE SALT COMPANY,

Appellee.

STATEMENT OF POINTS UPON WHICH APPELLANT INTENDS TO RELY ON APPEAL

Appellant adopts as points on appeal the statement of points filed with the court below and included in the Transcript of Record on file herein.

LLOYD H. BURKE,
United States Attorney.

/s/ GEORGE A. BLACKSTONE,
Assistant U. S. Attorney,
Attorneys for Appellant.

[Endorsed]: Filed June 18, 1953.

[Title of Court of Appeals and Cause.]

DESIGNATION OF RECORD ON APPEAL

The appellant, upon its appeal from the judgment entered in the above cause on March 2, 1953, desig-

nates the entire record to be printed, together with all original exhibits.

LLOYD H. BURKE,
United States Attorney.

/s/ GEORGE A. BLACKSTONE,
Assistant U. S. Attorney,
Attorneys for Appellant.

[Endorsed]: Filed June 18, 1953.

[Title of Court of Appeals and Cause.]

MOTION FOR PERMISSION TO WAIVE PRINTING OF CERTAIN EXHIBITS

Comes Now the appellant in the above-entitled cause, by its attorney of record and respectfully asks this Court to waive the printing of Exhibits 4 through 6, inclusive, received in evidence in this case, and to permit those original exhibits to be considered and referred to by this Court and by counsel in the same manner as though they were contained in the printed record on appeal.

This motion is made and based upon a stipulation of the parties that is made a part of the record.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General.

/s/ BRUCE M. CASEY, JR.,
Attorneys for Appellee.

So Ordered:

/s/ WILLIAM DENMAN,
Chief Judge.

/s/ WM. E. ORR.
/s/ HOMER T. BONE,
United States Circuit Judges.

[Title of Court of Appeals and Cause.]

STIPULATION NOT TO PRINT CERTAIN EXHIBITS

Comes Now the parties above named by their attorneys of record who agree that inasmuch as Exhibits 4 through 6, inclusive, are duplications of plaintiff's Exhibits 1 through 3, inclusive, except for the names of the lending institutions and the amounts loaned, that Exhibits 4 through 6, inclusive, need not be printed but those exhibits may be considered and referred to by the Court and by counsel in the same manner as though they were contained in the printed record on appeal.

Dated: July 10, 1953.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General;

/s/ BRUCE M. CASEY, JR.,
Attorneys for Appellee.

[Endorsed]: Filed July 13, 1953.

No. 13873

United States Court of Appeals for the Ninth Circuit.

UNITED STATES OF AMERICA,

Appellant,

vs.

LESLIE SALT COMPANY,

Appellee.

Supplemental Transcript of Record

Appeal from the United States District Court for the Northern District of California Southern Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—9-11-53

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

PLAINTIFF'S EXHIBIT No. 1

Leslie Salt Co.
$3\frac{1}{4}$% Sinking Fund Promissory Note
Due February 1, 1964

San Francisco, California,
February 1, 1949.

$3,000,000.

Leslie Salt Co., a Delaware corporation (herein called the "Company"), for value received, hereby promises to pay to

The Mutual Life Insurance Company of New York or order, on the first day of February, 1964,

Three Million Dollars

and to pay on August 1 and February 1 in each year interest on the unpaid balance thereof from the date of this Note at the rate of three and one-quarter per cent ($3\frac{1}{4}$%) per annum until the principal hereof shall have become due and payable, and thereafter, if default be made in the payment of such principal, at the rate of six per cent (6%) per annum. Any overdue installment of interest on this Note shall bear interest at the rate of six per cent (6%) per annum to the extent that payment of such interest on overdue interest is enforceable under applicable law. Both the principal hereof and interest hereon are payable at the principal office of The Guaranty Trust Company of New York, in the Borough of Manhattan, The City of New York, in coin or currency of the United States of America

which at the time of payment shall be legal tender for the payment of public and private debts.

This Note is one of one or more Notes (herein called the "Notes"), each of the denomination of $1,000 or a multiple thereof, made or to be made by the Company in an aggregate principal amount of Four Million Dollars ($4,000,000), all of the Notes maturing on February 1, 1964, and bearing interest payable at the same rate and on the same dates as the interest on the principal amount of this Note.

The holder of this Note at his option may surrender the same for exchange at the office of the Company and without expense receive in exchange therefor a Note or Notes in authorized denominations, dated as of the date to which interest has been paid on this Note, and payable to the holder or to such person or persons as may be designated by such holder, or order, for the same aggregate principal amount as the unpaid principal amount of this Note. Every Note made and delivered in exchange for this Note shall in all other respects be in the same form and have the same terms as this Note.

Upon each payment in reduction of the principal of this Note, a notation of the date and amount thereof shall be made hereon, or, at the option of the Company or the holder of this Note, this Note shall be surrendered by the holder at the office of the Company in exchange for a new Note in the principal amount remaining unpaid dated as of the date to which interest has been paid on this Note.

This Note is issued under and is entitled to the

benefits of the provisions of an Agreement of the Company dated February 1, 1949, with respect to the Notes, a copy of such Agreement being on file at the principal office of the Company. As provided in said agreement the Notes may be prepaid prior to maturity at the option of the Company. As further provided in said agreement, the Notes are entitled to the benefits of the sinking fund provided for therein and are subject to prepayment through the operation of such sinking fund. In case an Event of Default, as defined in said agreement, has occurred, the principal of the Notes may be declared or may become due and payable in the manner, at the time, and with the effect provided in said Agreement.

In Witness Whereof, Leslie Salt Co. has caused this Note to be signed in its corporate name by its President or one of its Vice-Presidents and by its Treasurer or an Assistant Treasurer; and this Note to be dated the day and year first above written.

LESLIE SALT CO.,

By ....,

President.

..............................,

Treasurer.

[Endorsed]: Filed November 24, 1952.

PLAINTIFF'S EXHIBIT No. 2

Leslie Salt Co.

Certificate of the Company Pursuant to Agreement Dated February 1, 1949

Leslie Salt Co., a Delaware corporation (herein called the "Company"), in order to induce The Mutual Life Insurance Company of New York to lend to the Company Three Million Dollars ($3,000,000) upon its $3\frac{1}{4}$% Sinking Fund Note (herein called the "Note"), in like principal amount and in compliance with the agreement between the Company and The Mutual Life Insurance Company of New York dated February 1, 1949 (herein called the "Agreement"), hereby certifies:

1.1. All facts which are represented in the Agreement to exist on the date thereof have continued to exist to the time of delivery of this certificate.

1.2. There has been no material adverse change in the assets or liabilities, or in the condition, financial or otherwise, of the Company from that set forth in its balance sheet as at October 31, 1948.

1.3. The Company owns, with immaterial exceptions, all properties and assets reflected in the balance sheet as at October 31, 1948, except property and assets disposed of in the ordinary course of business, and there are no liens, charges or encumbrances on any of its assets, except as permitted by Paragraph 7.2 of the Agreement.

1.4. There are no actions, suits or proceedings pending or, to the knowledge of the Company

threatened, against or affecting the Company or a Subsidiary, at law or in equity or before or by any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, which in the opinion of the signers could result in any material adverse change in the business, properties or assets or in the condition, financial or otherwise, of the Company and its Subsidiaries.

1.5. Neither the Company nor any Subsidiary is a party to any contract or agreement, or subject to any charter or other corporate restriction, which materially and adversely affects its business, properties or assets, or its condition, financial or otherwise, or conflicts with the provisions of the Agreement.

1.6. Performance of the Agreement and compliance with its terms will not violate any provision of law or of the charter or bylaws of the Company or any Subsidiary and will not conflict with or result in a breach of any of the terms, conditions or provisions of, or constitute a default under, or result in the creation or imposition of any lien, charge or encumbrance upon any of the property or assets of the Company or any Subsidiary pursuant to the terms of, any agreement or instrument to which the Company or any Subsidiary is a party or which it has assumed.

1.7. The Company and its Subsidiaries own, or possess adequate licenses or other rights to use, all trade-marks, trade names, copyrights and patents

necessary to conduct the business of this Company and its Subsidiaries as now operated without known conflict with the asserted rights of others.

1.8. The Company has not, either directly or through any agent, attempted or offered to dispose of the Note, or solicited any offers to buy the Note from, or otherwise approached in connection therewith or negotiated in respect thereof, with, any person or persons other than the two purchasers referred to in the Agreement.

1.9. The business and properties of the Company have not between October 31, 1948, and the date of this Certificate, been materially and adversely affected as the result of any fire, explosion, earthquake, accident, strike, lockout, combination of workmen, priority order of the United States of America or any agency thereof, flood, drought, embargo, confiscation of any plant or of vital materials or inventories by the United States of America or any agency thereof, riot, activities of armed forces, or acts of God or the public enemy.

1.10. The Company is not, upon the execution of the Note, in default in the performance of any of the covenants of the Agreement.

The foregoing representations supersede any previous oral or written statements and are not to be altered or limited by any simultaneous oral or written statement.

In Witness Whereof, Leslie Salt Co. has caused this certificate to be signed in its corporate name

by its President and its corporate seal to be affixed and attested by its Secretary the 15th day of February, 1949.

LESLIE SALT CO.,

[Seal] By FRED B. BAIN,
President.

Attest:

SHELDON ALLEN,
Secretary.

[Endorsed]: Filed November 22, 1952.

PLAINTIFF'S EXHIBIT No. 3

Leslie Salt Co.
310 Sansome Street,
San Francisco, California

February 1, 1949.

The Mutual Life Insurance Company of New York,
34 Nassau Street,
New York 5, N. Y.

Dear Sirs:

Leslie Salt Co., a Delaware corporation (herein called the "Company"), agrees with you as follows:

Section 1. Sale of Note.

1.1. The Company will authorize the issue of two promissory notes in the aggregate principal amount of Four Million Dollars ($4,000,000), to bear interest at the rate of three and one-quarter

per cent ($3\frac{1}{4}\%$) per annum, to be dated February 1, 1949, and to mature February 1, 1964, having terms and provisions substantially as set forth in Exhibit A hereto, with such changes therein, if any, as shall be approved by you and by the Company.

The term "Notes" shall include the aforesaid two notes and each note delivered in substitution therefor; and, where applicable, shall include the singular number as well as the plural. The term "Note" shall mean one of the Notes. The Notes shall be printed and shall be exchangeable and interchangeable as provided therein.

1.2. Subject to the terms and conditions herein set forth, the Company hereby agrees to sell to you and you hereby agree to purchase from the Company on a date (herein called the "closing date") to be fixed by the Company by five (5) days notice in writing to you, not later than February 28, 1949, a Note dated February 1, 1949, in the principal amount of Three Million Dollars ($3,000,000).

1.3. On the closing date, upon delivery to you of such Note you will pay to the Company as the purchase price of such Note an amount equal to one hundred per cent (100%) of the principal amount of such Note, plus an amount equal to interest thereon from the date of such Note to the closing date.

1.4. Delivery of the Note shall be made at the office of the Company, 310 Sansome Street, San Francisco, California, against your payment of the purchase price in current San Francisco funds.

Section 2. Representations.

2.1. The Company has delivered to you:

(1) Balance sheets of the Company as at October 31, 1944, 1945, 1946, 1947 and 1948 and statements of profit and loss and of the surplus accounts for the years ended on said dates, certified by Messrs. McLaren, Goode & Co., Certified Public Accountants, and a balance sheet of the Company as at December 31, 1948, and a statement of profit and loss and of the surplus accounts of the Company for the two months period ended on said date, certified by a financial officer of the Company.

(2) A brief description of the business and properties of the Company.

(3) A list of corporations of which the Company owns substantial percentages of stock, showing the place of incorporation of each and the percentage of stock of each owned by the Company.

All of such statements have been marked "Exhibit B to Agreement dated February 1, 1949."

The Company represents that:

2.2. Such financial statements so delivered are correct and complete and fairly present, respectively, the financial condition of the Company as at the dates specified therein and the results of its operations for the respective periods specified therein.

2.3. The above-mentioned balance sheet of the Company as at December 31, 1948, reflects all liabilities, contingent or otherwise, of the Company at such date, except liabilities which are not required to be so reflected in accordance with sound account-

ing practice. Such liabilities not so reflected were incurred in the ordinary course of business and do not in the aggregate have any material adverse effect upon the position of the Company.

2.4. The above-mentioned financial statements have been prepared in accordance with sound accounting practice, consistently maintained throughout the periods involved except as otherwise specifically indicated therein.

2.5. The net earnings of the Company available for fixed charges for the period of five fiscal years ended October 31, 1948, have averaged per year not less than one and one-half times its average annual fixed charges applicable to such period and during the fiscal year ended October 31, 1948, such net earnings available for fixed charges were not less than one and one-half times its fixed charges for such year. As used in this sub-paragraph the terms "net earnings available for fixed charges" and "fixed charges" have the meanings assigned to them in Section 81 (2) of the New York Insurance Law.

Section 3. Conditions of Purchase.

Your obligation to purchase and pay for the Note shall be subject to the conditions set forth in the following Paragraphs 3.1 to 3.5, inclusive:

3.1. The Company shall deliver to you at the closing of the sale of the Note, a Certificate of the Company, duly authorized, executed and delivered by the Company, substantially in the form of the Certificate annexed hereto, marked Exhibit C, the truth and accuracy of which, at the time of closing,

shall be conditions precedent to your obligations hereunder.

3.2. You shall have received from Messrs. Bainton, McNaughton, Douglas & Leiby, your special counsel in connection with this transaction, and from Messrs. Chickering & Gregory, counsel for the Company, their opinions in form and substance satisfactory to you that—

(i) The Company is a duly organized and validly existing corporation, in good standing under the laws of its state of incorporation and having the corporate power to conduct its business.

(ii) This agreement has been duly authorized by the Company and duly executed and delivered by an authorized officer of the Company and constitutes a valid and legally binding obligation of the Company, enforceable in accordance with its terms.

(iii) The Note has been duly authorized by the Company and duly executed and delivered by authorized officers of the Company and is a valid and legally binding obligation, enforceable in accordance with its terms.

(iv) The Certificate of the Company delivered by the Company pursuant to Paragraph 3.1 of this Agreement has been duly authorized, executed and delivered by authorized officers of the Company, and such certificate is an instrument binding upon the Company, entitling you to remedies provided by law against the Company in case of any material misrepresentations therein.

(v) The permission and consent required of the Corporation Commission of the State of California

to the issuance and sale of the Note have been duly and regularly obtained. No other authorization of governmental authority is required for the issuance and sale of the Note.

(vi) The offering, issue and delivery of the Notes, under the circumstances contemplated by this Agreement, constitute an exempted transaction under the Securities Act of 1933, as amended, and do not require registration of the Notes thereunder; it is not necessary in connection therewith to qualify an indenture in respect thereof under the Trust Indenture Act of 1939; and since you are acquiring the Note for investment and not with a view to distribution, if you should in the future deem it expedient to sell the Note or any of the New Notes (which you do not now contemplate or foresee), such sale would be an exempted transaction under the Securities Act of 1933, as amended, and would not of itself require registration of the Note or the New Notes thereunder, although such registration would be required as a condition of any distribution by underwriters, as defined in said Act, if at the time of sale you control the Company.

3.3. You shall receive from said Messrs. Chickering & Gregory, counsel for the Company, their further opinion in form and substance satisfactory to you that (i) the Subsidiaries are duly organized and validly existing corporations, in good standing under the laws of their respective places of incorporation, (ii) the Company owns all shares of stock referred to in Exhibit B hereto as owned by the Company and such shares are validly issued, fully

paid and non-assessable, (iii) the Company is duly qualified to do business in California and (iv) (with possible exceptions of no material importance) the title of the Company to its properties and assets is as represented in Clause 1.3 of the form of Certificate of the Company annexed hereto marked Exhibit C. In rendering the opinion required by the foregoing Clause (i), counsel for the Company may rely upon the opinions of local counsel; in rendering the opinion required by the foregoing Clause (ii), counsel for the Company may rely upon the opinions of local counsel insofar as such opinion relates to the shares being validly issued, fully paid and non-assessable; and in rendering the opinion required by the foregoing Clause (iii), said counsel may rely on policies of title insurance issued by reputable companies and, as to matters not of public record, upon certificates of officers of the Company as to relevant facts.

3.4. The Company shall have entered into a separate agreement with another investor (who shall have represented to the Company that it is purchasing the Note for its own account, for investment, and not with a present view of the distribution thereof), with reference to the sale of the balance of the Four Million Dollars ($4,000,000) principal amount of the Notes, and shall have sold such Note to such other investor concurrently with the closing hereunder.

3.5. All proceedings to be taken in connection with the transactions contemplated by this Agree-

ment and all documents incident thereto, shall be satisfactory in form and substance to you and your special counsel; and you shall receive copies of all documents which you may reasonably request in connection with said transactions and all corporate proceedings in connection therewith in form and substance satisfactory to you and your special counsel.

Section 4. Purchase for Investment; New Indenture.

4.1. This Agreement is made by the Company in reliance upon your representation that you are acquiring the Note to be issued to you hereunder for your own account, and not with a view to, or for sale in connection with, the distribution thereof; and that you have no present intention of selling or distributing said Note, it being understood, however, that the disposition of your property shall at all times be within your control.

4.2. The Company agrees that so long as you hold one or more of the Notes and the aggregate principal amount of the Note or Notes held by you is Three Hundred Thousand Dollars ($300,000) or more, the Company will as soon as reasonably possible after the receipt of a written request from you, execute and deliver at the expense of the Company, a trust indenture (hereinafter called the "New Indenture") providing for the issue thereunder of 3¼% Sinking Fund Notes of the Company due February 1, 1964 (herein called the "New Notes"), limited to the principal amount of the Notes unpaid

at the date of execution of the New Indenture, bearing interest at the rate and entitled to the substantive benefits of the Notes. The New Notes shall be issuable (except in case of destroyed, lost or stolen New Notes and in case of exchanges, interchanges, transfers, reissues, etc., of New Notes) only against surrender of the Notes. The New Indenture shall be delivered to a bank or trust company selected by the Company having a combined capital and surplus of not less than Three Million Dollars ($3,000,000), in good standing and having its principal office in the Borough of Manhattan, The City of New York, or in San Francisco, California, which is authorized by law to exercise corporate trust powers and is subject to supervision or examination by federal or state authority.

The New Indenture shall be substantially as set forth in Exhibit D hereto.

4.3. After the execution of the New Indenture, upon surrender of a Note or Notes by you, the Company will deliver without charge to you, in exchange therefor, New Notes in an aggregate principal amount equal to the unpaid principal amount of the Note or Notes so surrendered, and of the same or a different authorized denomination or denominations (One Thousand Dollars [$1,000] or a multiple thereof) and either in registered form without coupons or in coupon form, and in printed or in fully engraved form, all as you may elect, and bearing interest from the date to which interest shall have been paid on the Note or Notes so sur-

rendered, all such New Notes delivered to you to be duly authorized, executed and delivered by the Company and valid and outstanding obligations of the Company, entitled to the benefits of the New Indenture in accordance with its and their terms and complying with the provisions of this Agreement, in the opinion of your counsel.

The Company will bear all expenses in connection with the preparation, execution and delivery of the New Indenture and the preparation, issue and delivery to you at your home office (including payment of all stamp and other taxes, except any tax on any transfer thereof) of any New Notes.

Section 5. Sinking Fund and Prepayment Provisions. Fixed Sinking Fund Payments.

5.1. On February 1, 1951, and thereafter annually on February 1 in each year to and including February 1, 1963, the Company will call for prepayment and prepay, without premium, a principal amount of the Notes equal to Two Hundred Eighty-five Thousand Dollars ($285,000), such prepayments being herein called "Fixed Sinking Fund Payments," and the dates upon which such payments are to be made being herein called "Fixed Sinking Fund Payment Dates." Prepayments made pursuant to other provisions of the Agreement shall not be deemed to anticipate Fixed Sinking Fund Payments.

Optional Sinking Fund Payments

5.2. On each Fixed Sinking Fund Payment Date, the Company, at its option, may call for prepay-

ment, on notice given as provided in Paragraph 5.3, and prepay, without premium, a further principal amount of the Notes equal to Two Hundred Eighty-five Thousand Dollars ($285,000), provided that the cash to be disbursed in connection with such prepayment represents the proceeds of earnings or of the liquidation of assets and neither has been nor will be raised or reimbursed to the Company directly or indirectly from other sources. If the Company shall not exercise any such option on any Fixed Sinking Fund Payment Date, such option shall lapse as to such date and may not be exercised at any time thereafter.

Optional Prepayments; Notice of Prepayment

5.3. At the option of the Company, upon giving written notice to the holders of the Notes to be prepaid not less than thirty (30) days nor more than sixty (60) days prior to the date fixed for prepayment, the entire principal amount of the Notes then outstanding may be called for prepayment and prepaid on any date, or any part thereof not less than Fifty Thousand Dollars ($50,000) may be called for prepayment and prepaid from time to time on any date, upon payment of the principal amount to be prepaid, together with unpaid interest accrued thereon to the date fixed for prepayment and a premium equal to the following respective percentages of the principal amount being prepaid:

If prepaid in the twelve months period ending January 31—	Premium
1950	3%
1951	3%
1952	3%
1953	2¾%
1954	2½%
1955	2¼%
1956	2%
1957	1¾%
1958	1½%
1959	1¼%
1960	1%
1961	¾%
1962	½%
1963	¼%
1964	None

5.4. Notice of call for prepayment having been given pursuant to Paragraph 5.3, the principal amount to be prepaid shall on the date designated in such notice become due and payable, with the applicable premium, if any, and interest.

Notation of Prepayment

5.5. Upon each payment in reduction of the principal of any Note, a notation of the date and amount thereof shall be made thereon, or, at the option of the Company or the holder of such Note, such Note shall be surrended by the holder at the office of the Company in exchange for a new Note in the principal amount remaining unpaid dated

as of the date to which interest has been paid on such Note.

Allocation of Prepayments

5.6. If payments are made under Paragraphs 5.1, 5.2 or 5.3 or if other payments of less than the entire principal amount of all Notes outstanding are made at any time, the Company will allocate the principal amount prepaid, in multiples of One Thousand Dollars ($1,000), among the several holders, if more than one, in proportion to the principal amounts then held by them respectively.

Notes Not to Be Reissued

5.7. To the extent that Notes are prepaid, in whole or in part, the portion so paid shall be cancelled, and no new Notes shall be reissued in respect of the amount so prepaid.

Section 6. General Covenants of the Company.

The Company represents, covenants and agrees that, from the date hereof and so long as you or your successors and assigns shall hold any of the Notes:

Payment of Taxes

6.1. The Company and its Subsidiaries (the term "Subsidiary" and various other terms used herein being defined in Paragraphs 8.1, et seq.) will promptly pay and discharge all lawful taxes, assessments and governmental charges or levies imposed upon them respectively or upon their respective incomes or profits, or upon any property, real, personal or mixed, belonging to them respectively; provided, however, that neither the Company nor

any Subsidiary shall be required to pay any such tax, assessment, charge, or levy, if the same shall not at the time be due and payable or can be paid thereafter without penalty or if the validity thereof shall currently be contested in good faith by appropriate proceedings and if the Company or such Subsidiary, as the case may be, shall have set aside on its books reserves deemed by it adequate with respect to any such tax, assessment, charge or levy.

Maintenance of Properties and Corporate Existence

6.2. The Company and its Subsidiaries will keep their respective properties in good repair, working order and condition, and from time to time will make all needed and proper repairs, renewals, replacements, extensions, additions, betterments and improvements thereto, so that the business carried on by the Company and its Subsidiaries may be properly and advantageously conducted at all times in accordance with prudent business management. The Company will, subject to the provisions hereof, maintain its corporate existence.

Books of Account

6.3. The Company and each Subsidiary will keep books of record and account in which full, true and correct entries will be made of all dealings or transactions in relation to their respective businesses and activities in accordance with sound accounting practice.

Accruals, Reserves

6.4. For the purposes of this Agreement, the Company and its Subsidiaries will reflect in their

respective applicable financial statements during any period, using estimates (subject to adjustment) if necessary as to periods less than a fiscal year:

(1) Appropriations to reserves for depreciation, depletion, obsolescence and/or amortization in an amount not substantially less than the amount accrued in accordance with sound accounting practice, claimed for such period by the Company or such Subsidiary, as the case may be, for Federal income tax purposes (subject to adjustment in respect of any part of such amount claimed but not allowed).

(2) Accruals in accordance with sound accounting practice for Federal and all other taxes for such period, including all taxes based on or measured by income or profits.

(3) All other appropriations to reserves which should be made in accordance with sound accounting practice in connection with the business conducted by the Company or such Subsidiary.

Insurance

6.5. The Company and each Subsidiary will keep all of their respective plants and properties and inventories which are of an insurable character insured by financially sound and reputable insurance companies or associations, against loss or damage by fire or explosion, in amounts sufficient to prevent the Company or such Subsidiary from becoming a co-insurer within the terms of the insurance policies covering such risks, and in any event in amounts not less than eighty per cent (80%) of the insurable value of the property insured. The

Company and each Subsidiary will also maintain insurance with such insurance companies and associations (or with a state-operated fund) against loss or damage from other hazards and risks to their properties, to the property of others and to the person, of the character and in amounts usually maintained by companies engaged in the same or a similar business similarly situated.

Financial Statements

6.6. Within ninety (90) days after the end of each fiscal year and within forty-five (45) days after the end of each first quarter-annual period, each first semi-annual period, and each third quarter-annual period (beginning with the period ending January 31, 1949), the Company will deliver to each holder of ten per cent (10%) or more in principal amount of the Notes, the following financial statements, in reasonable detail: (a) a balance sheet of the Company as at such date, (b) a statement of income for such period ended on such date, (c) an analysis of the surplus account for such period, (d) an analysis of Stock Payments made during such period and (e) a copy of the detailed reports, if any, submitted by independent accountants in connection with such of the financial statements as have been certified by independent accountants.

The Company will also deliver to each such holder of the Notes within ninety (90) days after the end of each fiscal year a balance sheet of each Subsidiary as at such date, a statement of the income

of each Subsidiary for such fiscal year and an analysis of the surplus account of each Subsidiary for such fiscal year.

The financial statements with respect to fiscal years shall be certified by an independent public accountant of recognized standing, or a firm of independent public accountants of recognized standing. Such accountant or firm of accountants shall be selected by the Company and approved by each holder of twenty per cent (20%) or more in principal amount of the Notes, if there be one or more such holders of Notes. The financial statements with respect to the first and third quarter-annual periods and the first semi-annual period in each year need not be audited but shall be certified by the Treasurer or an Assistant Treasurer of the Company.

If the Company shall at any time change its fiscal year the interim period, if less than a full quarter-annual period, shall be treated as a quarter-annual period.

Compliance Certificates

6.7. Concurrently with the delivery of financial statements with respect to each fiscal year, the Company will deliver to each holder of ten per cent (10%) or more in principal amount of the Notes a written statement of the independent public accountant or firm of independent public accountants which shall have certified such financial statements, to the effect that in making the audit necessary to said certification, they have obtained no knowledge

of any default hereunder, except as specifically indicated.

6.8. Concurrently with each delivery of financial statements with respect to each fiscal year, the Company will deliver to each holder of ten per cent (10%) or more in principal amount of the Notes a Certificate of the President or a Vice-President of the Company stating that, to the best of his knowledge, except as specifically indicated, the Company is not in default in its obligations hereunder.

Section 7. Particular Covenants of the Company.

From the date hereof and so long as you or your successors and assigns shall hold any of the Notes:

Liabilities

7.1. Neither the Company nor any Subsidiary will create, assume, incur or in any other manner become or remain liable in respect of or suffer to continue in existence, any Indebtedness other than Indebtedness described in one or more of the following Clauses (1) to (6), inclusive:

(1) The Notes and any New Notes issued pursuant to Paragraphs 4.2 and 4.3 in exchange for Notes.

(2) Unsecured Current Liabilities of the Company or a Subsidiary, not more than six months overdue unless contested in good faith, provided that:

(a) The Company shall not incur any liability for money borrowed pursuant to this Clause (2)

except for loans from commercial banks incurred in the ordinary course of the business of the Company.

(b) No Subsidiary shall incur any liability for money borrowed except as expressly permitted by Clauses (3) and (4) hereof.

(3) Purchase Money Obligations of the Company or a Subsidiary permitted by Clause (4) of Subdivision A of Paragraph 7.2, not overdue, in an aggregate amount not exceeding Two Hundred Fifty Thousand Dollars ($250,000) at any one time outstanding of the Company and all Subsidiaries.

(4) Indebtedness of a Subsidiary to the Company.

(5) Current Liabilities of the Company or a Subsidiary for taxes, assessments, governmental charges or levies to the extent that payment thereof shall not at the time be required to be made in accordance with the provisions of Paragraph 6.1.

(6) Current Liabilities of the Company or a Subsidiary in respect of judgment or awards, or which are the subject of attachment, to the extent that payment thereof shall not at the time be required to be made in accordance with the provisions of Clause (2) of Subdivision A of Paragraph 7.2.

Salter Machine Co. will not create, assume, incur or in any other manner become or remain liable in respect of or suffer to continue in existence any Indebtedness for money borrowed from persons other than the Company in excess of an aggregate amount of Fifteen Thousand Dollars ($15,000) at any time outstanding, exclusive of moneys borrowed

which are to be repaid solely from rentals paid by lessees of the machines of Salter Machine Co. in connection with bona fide leases thereof made by said company.

Liens, Priority Claims, Certain Transfers

7.2. Neither the Company nor any Subsidiary will:

Create or permit to continue in existence any mortgage, pledge, encumbrance, lien or charge of any kind upon any of its property or assets, whether owned at the date hereof or hereafter acquired; or

Transfer any of such property or assets if in connection with such transfer the same will be subjected to the payment of obligations of the Company or a Subsidiary (including without limitation obligations to pay installments upon purchase contracts or to pay rent, whether or not deemed Indebtedness); or

Transfer any of its notes receivable or accounts receivable with recourse; or

Acquire or agree to acquire any property or assets upon conditional sales agreement, lease-purchase agreement or other title retention agreement; or

Suffer to exist for a period of more than thirty (30) days after the same shall have been incurred any indebtedness or liability of, or claims or demands against, the Company or such Subsidiary which, if unpaid, might (in the hands of the holder or any one, including the United States of America, who shall have guaranteed the same or who has any right or obligation to purchase the same) by law

or upon bankruptcy or insolvency, or otherwise, be given any priority whatsoever, over its general creditors,

except that:

A. The Company or any Subsidiary may create, incur, suffer to be created or incurred or to exist—

(1) Liens, charges, encumbrances and priority claims which (a) are incidental to the conduct of its business or the ownership of its properties and assets, which (b) were not incurred in connection with the borrowing of money or the obtaining of advances or credit, and which (c) do not in the aggregate materially detract from the value of its property or materially impair the use thereof in the operation of its business.

(2) Liens in respect of judgments or awards, provided that the same are discharged within sixty (60) days after entry, or as to which the Company or such Subsidiary at the time shall in good faith be prosecuting an appeal or proceedings for review and as to which the Company or such Subsidiary shall have secured a stay of execution pending such appeal or proceedings for review, and liens in respect of attachments which are discharged within sixty (60) days after entry, or which shall have been bonded and as to which the Company or such Subsidiary at the time shall in good faith be conducting proceedings.

(3) Liens and/or priority claims for taxes or assessments or governmental charges or levies if payment of the same shall not at the time be re-

quired to be made in accordance with the provisions of Paragraph 6.1.

(4) Liens upon, or conditional sales agreements, lease-purchase agreements or other title retention agreements affecting, real estate, machinery, or equipment purchased after February 1, 1949, securing the payment of a portion of the purchase price of such real estate, machinery or equipment or existing on such real estate, machinery or equipment at the time of acquisition thereof, or extensions or renewals or refundings thereof, provided that—

(a) The Indebtedness secured by such lien, conditional sales agreement, lease-purchase agreement or title retention agreement (herein called "Purchase Money Obligations") shall not exceed sixty-six and two-thirds per cent (66⅔%) of the cost of the property subject thereto (or the fair value thereof to the Company or such Subsidiary at date of acquisition, if less than cost) to the Company or such Subsidiary.

(b) Every such lien shall be expressly limited to the property subject thereto and, in the case of real property, fixed improvements erected or to be erected thereon.

(c) The Purchase Money Obligation in question shall be permitted by Clause (3) of Paragraph 7.1.

B. A Subsidiary may mortgage or pledge or otherwise encumber all or any part of its assets to secure any obligation owing to the Company.

C. The Company or any Subsidiary may in the ordinary course of business endorse or deposit for collection or sell without recourse notes receivable, accounts receivable, drafts and trade acceptances.

Dividends, Purchase of Stock, etc.

7.3. The Company will not—

Declare any dividends on any of its stock;

Directly or indirectly or through any Subsidiary purchase, or redeem or retire or give notice of redemption or retirement of, any of the stock of the Company; or

Make any other distribution in cash or property to the holders of its stock;

(such declarations of dividends, purchases, redemptions, retirements, distributions [excluding, however, any such which may be payable solely in common stock of the Company] being herein collectively called "Stock Payments"), except as follows:

(1) The Company may make Stock Payments if and to the extent that, after giving effect thereto, the Amount of all Stock Payments for the period subsequent to October 31, 1948, taken as one accounting period, will not be greater than the excess if any of

(a) The sum of (i) the Net Income of the Company for such period subsequent to October 31, 1948, plus (ii) Five Hundred Thousand Dollars ($500,000), over

(b) An amount equal to Twenty Thousand Eight Hundred Thirty-three Dollars ($20,833) multiplied by the number of full calendar months elapsed from November 1, 1948, to the earliest of (i) the end of the calendar month next preceding the date of such Stock Payment, (ii) November 1, 1956, or (iii) the end of the calendar month in

which the aggregate principal amount of the Notes is reduced to Two Million Dollars ($2,000,000).

(2) The Company may declare and pay dividends payable solely in common stock of the Company or make other distributions to holders of stock of the Company if such distributions are made solely in common stock of the Company and may make exchanges of common stock of the Company for other stock of the Company or may acquire stock of the Company out of the proceeds of the substantially concurrent sale of other shares of its common stock.

The Company will not declare any dividend payable more than ninety (90) days after the date of declaration thereof.

The Company will not become or be liable under any agreement to purchase stock of the Company if such purchase would be prohibited by the provisions of this Paragraph 7.3.

The Company may credit against Stock Payments of the character of purchases, redemptions and retirements of stock of the Company the net consideration, in cash or property (other than stock of the Company), received upon the sale subsequent to October 31, 1948, of common stock of any class of the Company.

Net Working Capital

7.4. The Net Working Capital of the Company will at all times be not less than One Million Dollars ($1,000,000).

Guarantees

7.5. Neither the Company nor any Subsidiary will guarantee or otherwise become secondarily liable for the payment by any other person of any debt, liability or dividend or for the value of any security nor permit any such secondary liability to continue in existence, except

(1) Endorsements for deposit in the ordinary course of business.

(2) Other secondary liability aggregating not in excess of Twenty-five Thousand Dollars ($25,000) at any time outstanding of the Company and all Subsidiaries.

Investments, Loans, Advances

7.6. Neither the Company nor any Subsidiary will acquire or hold any stock of, or make or have any other investment in any securities of, or make or have outstanding any loan or advance to, any person, except as permitted by one or more of the following Clauses (1), (2), (3) and (4):

(1) The Company may acquire and hold stock of, and make and have other investments in securities of, and make and have outstanding loans and advances to, (a) Subsidiaries existing as such on February 1, 1949, without limit as to amount, (b) one or more Wholly-owned Subsidiaries, without limit as to amount, and (c) Salter Machine Co., in an aggregate amount not exceeding Fifty Thousand Dollars ($50,000), exclusive of expenditures to acquire stock of said Company outstanding December 31, 1948.

(2) The Company and any Subsidiary may acquire and hold direct obligations of the United States of America without limit as to amount.

(3) The Company and any Subsidiary may acquire and hold its own stock or other of its own securities.

(4) The Company and Subsidiaries may acquire and hold stock of, and make and have other investments in securities of, and make and have outstanding loans and advances to, other persons, provided that the aggregate investment at any one time outstanding pursuant to this Clause (4) shall not exceed Fifty Thousand Dollars ($50,000).

Issue of Stock of Subsidiaries, Consolidation, Merger, etc., of Subsidiaries

7.7. No Subsidiary will,—

A. Issue or dispose of any of its stock or other securities to any person other than the Company except to the extent, if any, that common stock may be issued to minority stockholders as their pro rata share of additional issues of stock.

B. Sell, lease, transfer or otherwise dispose of, except in the ordinary course of business, any substantial part of its assets to any person other than the Company or (except in connection with mergers or consolidations permitted by Paragraph 7.9) consolidate with or merge into any person, or permit any person to merge into it.

Partial Disposition of Subsidiaries

7.8. Neither the Company nor any Subsidiary will sell, assign, transfer, dispose of, or in any way

part with the control of, any shares of stock of, or indebtedness owed to the Company or any Subsidiary by, any Subsidiary, except to the Company or a Wholly-owned Subsidiary, unless simultaneously therewith all such shares of stock and indebtedness (except indebtedness incurred in the ordinary course of business) of such Subsidiary at the time owned by the Company and all Subsidiaries shall be sold as an entirety to a person other than an affiliate for a consideration in cash which, in the opinion of the Board of Directors of the Company evidenced by a resolution thereof, represents the fair value at the time of sale of the shares and indebtedness so sold, provided that such sale will not materially and adversely affect the conduct of the business of the Company and its other Subsidiaries nor be disadvantageous in any material respect to the holders of the Notes.

Consolidation, Merger, etc.

7.9. The Company will not sell, transfer or otherwise dispose of any substantial part of its assets except in the ordinary course of business, and will not consolidate with, or merge into, any person, except a Wholly-owned Subsidiary or permit any other person (except a Wholly-owned Subsidiary) to merge into the Company, and no such consolidation with or merger into, any such Wholly-owned Subsidiary shall be effected unless such Wholly-owned Subsidiary (if it be the successor corporation) shall expressly assume the obligations of the Company under this Agreement and the Notes and

unless after giving effect thereto, no default shall exist in the performance of any of the covenants, conditions or agreements of this Agreement and the Notes.

For the purposes of Paragraph 7.7 and this Paragraph 7.9 assets shall be deemed to be a substantial part of the assets of the Company or a Subsidiary if the book value thereof after depreciation, when added to the book value after depreciation (at the time of disposition) of all other assets disposed of since February 1, 1949, not in the ordinary course of business, by the Company or such Subsidiary, as the case may be, would exceed ten per cent (10%) of the book value after depreciation of all of the assets of the Company or such Subsidiary, as the case may be, at the time of the proposed disposition.

Leases

7.10. Neither the Company nor any Subsidiary will become or be liable as lessee under any lease of real or personal property having a term of more than three years or as vendee in possession under any contract to purchase real or personal property, having a term greater than one year, if, thereafter, the aggregate amount of rental and installments of purchase price accrued and to accrue, required to be paid by the Company and its Subsidiaries under all such leases having a term of more than three years, and under all such contracts having a term greater than one year, will be in excess of Twenty-five Thousand Dollars ($25,000) in any period of twelve consecutive months, exclusive of any rental

and installments of purchase price payable under leases and contracts incurred pursuant to Clause (4) of Subdivision A of Paragraph 7.2 and exclusive of rentals of office space or office equipment.

Change of Business

7.11. The Company will not change the general character of its business.

Waiver

7.12. Upon the written consent of the holders for the time being of at least eighty per cent (80%) of the principal amount of the Notes at the time outstanding (i) compliance with any of the covenants and conditions set forth in Paragraphs 6.1 to 7.11, inclusive, may be waived and (ii) changes and modifications in the provisions of Paragraphs 6.1 to 8.14 (except this Paragraph 7.12) may be made.

Section 8. Definitions.

For the purposes of this Agreement and any certificates delivered pursuant to this Agreement:

8.1. "Company" shall mean Leslie Salt Co., a Delaware corporation, and its successors.

8.2. "Person" shall mean an individual, a corporation, a partnership, a trust or unincorporated organization, or a government or political subdivision thereof.

8.3. "Subsidiary" shall mean any corporation more than fifty per cent (50%) of the issued and outstanding stock of which having ordinary voting power (other than stock which has acquired such power only by reason of the happening of a con-

tingency) shall at the time be owned or controlled, directly or through any intervening medium, by the Company.

"Wholly-owned Subsidiary" of a corporation shall mean a Subsidiary all of the issued and outstanding stock of which (except directors' qualifying shares) shall at the time be owned by such corporation.

8.4. "Indebtedness" of any person shall include all obligations of such person which in accordance with sound accounting practice shall be classified upon a balance sheet of such person as liabilities of such person, and in any event shall include all indebtedness, debt and other similar monetary obligations of such person, whether direct or guaranteed.

"Indebtedness" shall also include (a) all Indebtedness secured by mortgage, pledge, lien, charge or encumbrance on assets owned by such person, whether or not such Indebtedness actually shall have been created, assumed or incurred by such person and (b) all obligations under agreements to pay installments of purchase price or other like payments with respect to fixed assets in possession of the purchaser, including obligations ostensibly to pay rent under which such person is to acquire an equity in the rented property.

In computing the amount of Indebtedness at any date, there shall be included an amount equal to all reserves at such date in respect of debts and other similar monetary obligations of such person, either direct or guaranteed.

8.5. "Current Liabilities" of any person shall include, at any date as of which the amount thereof shall be determined, all Indebtedness of such person which would, in accordance with sound accounting practice, be classified as current liabilities, in any event including

(1) All Indebtedness of such person payable on demand or maturing not more than one year after such date, including all serial maturity and fixed sinking fund payments.

(2) Reserves, adequate in the opinion of such person, in respect of contingent or disputed obligations which do not mature by their terms more than one year after such date, excluding, however, any reserves which are in effect mere subdivisions of surplus or offsets to asset values.

(3) All Indebtedness of such person due to a Subsidiary thereof, regardless of maturity date.

(4) Accruals for Federal and other taxes based on or measured by income or profits, provided that there may be offset against Federal taxes, tax savings notes issued by the United States of America, at principal amount plus accrued interest.

8.6. "Funded Debt" of any person shall include at any date as of which the amount thereof is to be determined, all Indebtedness of such person not included or provided for within the foregoing definition of Current Liabilities at such date.

8.7. "Current Assets" of any person shall include all assets of such person which in accordance with sound accounting practice shall be so classified, all after deduction of all reserves properly de-

ductible from such assets in accordance with sound accounting practice; and may include readily marketable securities issued by the government of the United States of America taken at a value not in excess of the current market value, but shall not include any of the following:

(1) Stocks, bonds or other like securities, except as aforesaid.

(2) Indebtedness owed to such first mentioned person by any other person, more than twenty-five per cent (25%) of the stock of any class of which is owned by such person, except to the extent that such Indebtedness arose in connection with the sale of merchandise, the performance of services or the rental of property in the ordinary course of business.

(3) Patents, patent applications, trade-marks, copyrights, trade names, good will, deferred expenses, unamortized debt discount and expense, or other like intangibles.

(4) Prepayments of interest and insurance.

8.8. "Net Working Capital" of any person shall mean the excess of the Current Assets of such person over the Current Liabilities of such person.

8.9. "Net Income" of any person for any period shall be determined by deducting from the amount of the gross income of such person for such period, all operating expenses and other proper deductions from income for such period, including (without limiting the generality of the foregoing) interest on all outstanding indebtedness, amortization of debt discount and expense, amortization of all other

deferred items properly subject to amortization, provision for all taxes, including income taxes, provisions for all contingency reserves, whether general or special, and provisions for depreciation and obsolescence in amounts not less than those actually deducted on the books of such person and not less than as required by the provisions of Clause (1) of Paragraph 6.4, provided, however, that

(1) Profits realized or losses sustained from the sale or other disposition of major items of capital assets or from the acquisition or retirement or sale of securities of such person or any Subsidiary of such person shall not be included.

(2) The Net Income of the Company for any fiscal year shall reflect as income or as a deduction from income, as the case may be, any adjustment (whether made through income or surplus accounts) which, although not attributable to such fiscal year, would be required to be made to compute Net Income of the Company for the period from October 31, 1948, through such fiscal year, and may reflect any restoration of any contingency reserve established after October 31, 1948, but shall not include material adjustments in respect of a period prior to, or mere reversals of reserves existing on, October 31, 1948.

(3) Dividends of Subsidiaries shall not be included unless paid from earned surplus arising since October 31, 1948.

8.10. "Stock Payment" shall have the meaning specified in Paragraph 7.3. The term "Amount" when used with reference to a Stock Payment, shall

mean the amount of cash paid or to be paid, and the net book value or the fair value, whichever is greater, at the time of distribution, of property distributed or to be distributed in respect of such Stock Payment.

8.11. Subject to the provisions of Paragraphs 8.1 to 8.10, inclusive, all computations to be made pursuant to this Agreement shall be made, and all financial statements shall be prepared, in accordance with sound accounting practice.

8.12. Whenever any computation to be made pursuant to this Agreement, is directed to be made "in accordance with sound accounting practice," such computation shall be made in accordance with sound accounting practice current at the time of such computation.

Section 9. Events of Default.

9.1. If one or more of the following events, herein called "Events of Default," shall happen and be continuing, the principal of the Notes with the premium thereon, if any, and accrued unpaid interest thereon shall upon demand of the holder of any of the Notes (if not already due and payable) become due and payable forthwith:

(1) Default be made in the punctual payment of any principal amount due under any of the Notes, when and as the same shall become due and payable.

(2) Default be made in the payment of any installment of interest on any of the Notes, and such default shall continue for thirty (30) days.

(3) Default be made in the due observance or performance of any covenant contained in Paragraphs 7.1 to 7.10, inclusive, of this Agreement.

(4) Default be made in the due observance or performance of any covenant contained in any Paragraph of this Agreement other than Paragraphs 7.1 to 7.10, inclusive, and such default shall continue for thirty (30) days after written notice thereof shall have been given to the Company by a holder of a Note.

(5) Final judgment for the payment of money which, with one or more other outstanding judgments, exceeds Fifty Thousand Dollars ($50,000) in aggregate amount, shall be rendered against the Company and the same shall not be discharged, or provision made for the discharge thereof in accordance with its terms within sixty (60) days from the entry thereof, or an appeal therefrom or other appropriate proceeding for the appellate review thereof, shall not be taken within said period and a stay of execution pending such appeal shall not be secured or if such appeal be taken and on such appeal the same shall be affirmed and the Company shall not discharge said judgment within sixty (60) days after the entry of the order or decree of affirmance.

(6) Either a petition shall be filed voluntarily, or filed and consented to, or filed and not dismissed within sixty (60) days (exclusive of any period during which a stay shall be in effect), seeking an order of the character mentioned below, or such an order shall be made by a court of competent juris-

diction and be in effect for sixty (60) days from the date of entry thereof:

(a) An order adjudicating the Company or a Subsidiary having assets of a net book value of Two Hundred Fifty Thousand Dollars ($250,000) or more (such a Subsidiary being hereinafter called a "Principal Subsidiary") a bankrupt, or

(b) An order appointing a trustee or receiver of the Company or a Principal Subsidiary or of any substantial part of their respective properties, or

(c) An order approving a petition for an arrangement in bankruptcy, a reorganization pursuant to the Federal Bankruptcy Act or any other judicial modification or alteration of the rights of the holders of the Notes or of other creditors of the Company or a Principal Subsidiary, or

(d) An order effecting such an arrangement, reorganization, modification or alteration, or

the Company or a Principal Subsidiary shall make an assignment for the benefit of its creditors.

Section 10. Miscellaneous.

10.1. To the extent permitted by applicable law, the Company hereby agrees to waive, and does hereby absolutely and irrevocably waive and relinquish the benefit and advantage of any valuation, stay, appraisement, extension or redemption laws now existing or which may hereafter exist, which, but for this provision, might be applicable to any sale made under the judgment, order or decree of any court, or otherwise, based on any Note or on any claim for interest on any Note.

10.2. The Company covenants that if default be made in any payment of principal, sinking fund or interest under any Note it will, to the extent that it may lawfully promise so to do, pay to the holder of such Note such further amount as shall be sufficient to cover the cost and expense of collection, including reasonable compensation to the attorneys of the holder for all services rendered in that connection.

10.3. The Notes are issued upon the express condition, to which each successive holder expressly assents and by receiving the same agrees, that no recourse under or upon any obligation, covenant or agreement of this Agreement or the Notes, or for the payment of the principal of, or the interest on, the Notes, or for any claim based on this Agreement or the Notes, or otherwise in respect thereof, shall be had against any incorporator or any past, present or future stockholder, officer or director, as such, of the Company or of any successor corporation, whether by virtue of any constitution, statute or rule of law or by any assessment or penalty or otherwise howsoever, all such individual liability being hereby expressly waived and released as a condition of and as part of the consideration for the execution and issue of the Notes; provided, however, that nothing herein shall prevent enforcement of the liability, if any, of any stockholder or subscriber to capital stock upon or in respect of capital stock not fully paid up."

10.4. No course of dealing between the Company and the holder of any Note or any delay on the part

of any holder in exercising any rights under any Note shall operate as a waiver of any rights of any holder of a Note.

10.5. This Agreement and the Notes shall be governed by the laws of the State of New York.

10.6. Notwithstanding any provision to the contrary in the Notes contained, the Company will pay all amounts payable to you in respect of the principal of, or premium or interest on, any of the Notes at your home office, at the address to which this Agreement is directed, or at such other address as may be designated in writing by you.

The Company has noted that all such amounts are payable in cash at the dates specified, and you have informed the Company that checks payable in funds other than those current at the place of payment will not be acceptable in lieu of cash unless received sufficiently in advance to become current funds at such dates.

All computations of interest for interim periods hereunder or under the Notes are to be made on the basis of a year of three hundred sixty-five (365) days.

The Company will promptly and punctually pay the interest on any Note held by you without any presentment of the Note and without any notation of such payment being made on the Note.

In connection with the making of any payment of principal you will make any Note available to the Company at your home office at any time during your regular business hours on the day such payment of principal is due, if the Company shall have

so requested at least fifteen days prior to such day, for the purpose of permitting the Company to make appropriate notation thereon, to the extent not theretofore made, of the amount of principal paid thereon. If the Company shall not make appropriate notation of any payment of principal on any Note held by you at the time such payment is made, you will promptly at the request of the Company make such notation.

In the event you shall sell any Note you will, prior to the delivery of such Note, make a notation thereon of the date to which interest has been paid on such Note and, if not theretofore made, a notation thereon of the extent to which any payment has been made on account of the principal thereof.

10.7. The Company agrees that after the execution and delivery of this Agreement and so long as you shall hold any of the Notes or any of the New Notes, you shall have the right at your own expense to visit and inspect under guidance of the Company the properties of the Company and its Subsidiaries, to examine their books of account and to discuss their affairs, finances and accounts with, and be advised as to the same by, their officers, all at reasonable times and at reasonable intervals.

10.8. The Company agrees to reimburse you for your out-of-pocket disbursements in connection with the sale contemplated by this Agreement, including the reasonable fee of Messrs. Bainton, McNaughton, Douglas & Leiby and the out-of-pocket disbursements of such firm in connection with the transaction contemplated by this Agreement.

10.9. The Company will pay any stamp taxes which may be payable in respect of the issue of the Notes, and its agreement in this connection shall survive the payment or prepayment of the Notes.

10.10. The descriptive section headings and paragraph headings herein have been inserted for convenience only and shall not be deemed to limit or otherwise affect the construction of any provision hereof.

10.11. All covenants, agreements and representations made herein and in certificates delivered in connection with the closing hereunder by or in behalf of the Company shall survive the execution and delivery of the Notes to you and payment therefor and shall bind and enure to the benefit of the successors and assigns of the Company, whether so expressed or not, and all such covenants, agreements and representations shall enure to the benefit of your successors and assigns, and to the benefit of all future holders of the Notes, whether so expressed or not, provided that the provisions of Paragraphs 4.2, 4.3 and 10.7 shall not be assignable.

10.12. This Agreement may be executed in any number of counterparts and all said counterparts executed and delivered each as an original shall constitute but one and the same instrument.

10.13. All communications provided for hereunder or in the Notes shall be in writing, mailed or delivered to the respective addresses set forth above, or such other address as may be designated in writing by the party to receive such notice, marked, if to you, for the attention of your Vice-President and

Manager of Securities Investment and if to the Company, for the attention of the President. In the event that the Note purchased by you, or any Note or Notes exchanged therefor, shall be transferred by you to another owner, such new owner shall register its address with the Company and thereafter such new owner shall be entitled to receive copies of all notices to be delivered hereunder.

10.14. This Agreement has been dated February 1, 1949, for convenient reference, but was actually delivered on the date shown in the form of acceptance below.

If the foregoing is satisfactory to you, please sign the form of acceptance on the enclosed counterpart of this letter and forward the same to the Company, whereupon this letter will become a binding agreement between you and the Company.

Very truly yours,

LESLIE SALT CO.,

By FRED B. BAIN,

President.

[Seal] SHELDON ALLEN,

Secretary.

The foregoing agreement is hereby accepted this 15th day of February, 1949.

THE MUTUAL LIFE INSURANCE COMPANY OF NEW YORK,

By STUART F. SILLOWAY,

Vice-President.

[Endorsed]: Filed November 24, 1952.

PLAINTIFF'S EXHIBIT No. 7

U. S. Treasury Department
Washington 25

Office of
Commissioner of Internal Revenue

Address Reply to
Commissioner of Internal Revenue
and Refer to ExT:M:AHG Cl. A-45354

July 20, 1951.

Leslie Salt Company,
505 Beach Street,
San Francisco 11, California.

Gentlemen:

Consideration has been given to your claim for refund of documentary stamp tax in the amount of $4,400.00 assessed and paid with respect to the issuance by you of instruments designated as "promissory notes" in the aggregate principal amount of $4,000,000.00.

Your claim is based on the contention that the above-mentioned notes do not come within the classes of instruments subject to tax under the provisions of section 1801 of the Internal Revenue Code.

The question involved is whether such instruments constitute debentures within the meaning of section 1801 of the Code and are accordingly taxable upon issue.

Under date of February 1, 1949, you entered into separate loan agreements with The Mutual Life Insurance Company of New York and the Pacific

Mutual Life Insurance Company, in which (1) The Mutual Life Insurance Company of New York agreed to purchase from you a note dated February 1, 1949, in the principal amount of $3,000,000.00, and (2) the Pacific Mutual Life Insurance Company agreed to purchase from you a note dated February 1, 1949, in the principal amount of $1,000,000.00. On February 15, 1949, the insurance companies purchased the notes in question at 100 per cent of the principal amounts, plus interest from February 1 to February 15, 1949. The notes bear interest at the rate of 3¼ per cent per annum, and will mature on February 15, 1964. The loan agreements provide for obligatory and optional prepayments on the principal of the notes and for acceleration of the maturity date of the notes upon the occurrence of specified events of default.

Under the terms of the loan agreements you are restricted with respect to other corporate financing and in the modification of your corporate structure. You are also restricted in the declaration of dividends, in the purchase or retirement of any of your capital stock and in the disposition of your assets. You are required to maintain a net working capital at all times of not less than $1,000,000.00. Periodically, you are required to furnish to the insurance companies certain financial statements of your corporation. At the time the loans were made you were required to furnish the insurance companies with opinions of your counsel covering a number of matters, including opinions to the effect that the agreements and the notes constitute valid and legally binding obligations of your corporation. The in-

surance companies represented that they were acquiring the notes for their own accounts and not with a view to sale or distribution thereof. The proceeds of the loan were used by you to retire outstanding bank loans and to finance certain construction work.

In the case of General Motors Acceptance Corporation v. Higgins (161 Fed. (2d) 593, Ct. D. 1708, C. B. 1948-2, 157; certiorari denied, 332 U. S. 810), it was held that certain instruments termed "notes" should be classified as "debentures" without regard to the name by which they are called. The Court held that the type of instruments there involved fell within a "class apart from ordinary commercial promissory notes and into the category of debentures as that term is used in the statute in its setting with bonds, and certificates of indebtedness, to designate a type of corporate securities which does not include ordinary promissory notes."

It is held by the Bureau that the instruments issued pursuant to the agreements involved in the present case create rights and liabilities not commonly associated with promissory notes. By their terms and provisions, the instruments represent a method of financing common to debentures, which is similar to that type of financing accomplished through the medium of a public issuance of investment securities under an indenture. Moreover, the instruments were issued by you as corporate borrower to obtain capital for use in your business under conditions similar to the sale of bonds, debentures, or other investment securities. The fact

that the borrowing is effected through one or more lenders, rather than the general public, is not material to the question here at issue.

The facts in this case, including the circumstances under which the notes were issued and the conditions of the loans, have all been very carefully considered by the Bureau. From an over-all standpoint and not based upon any particular factor or condition, it is held by the Bureau, in the light of the decision in the General Motors Acceptance Corporation case, supra, that the instruments involved in the present case should be classed as debentures. This conclusion is consistent with the position of the Bureau in other cases involving substantially similar facts. Moreover, this conclusion is sustained by the decision of the United States District Court for the District of Maryland, rendered October 24, 1950, in the case of Commercial Credit Company v. Hofferbert, Collector (93 Fed. (Supp.) 562), which was affirmed on May 7, 1951, by the Circuit Court of Appeals for the Fourth Circuit. Accordingly, the issuance of the notes in question is subject to the tax imposed by section 1801 of the Code.

In view of the foregoing, your claim is rejected in full.

Very truly yours,

GEORGE J. SCHOENEMAN,
Commissioner.

By /s/ CHARLES J. VALAER,
Deputy Commissioner.

[Endorsed]: Filed November 24, 1952.

138 *Minute entry of argument and submission*

[omitted in printing].

December 15, 1954

139 In United States Court of Appeals for the Ninth Circuit

Order directing filing of opinion and filing and recording of judgment

December 16, 1954

Ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the Clerk, and that a Judgment be filed and recorded in the minutes of the Court in accordance with the opinion rendered.

140 In United States Court of Appeals for the Ninth Circuit

No. 13873, Dec. 16, 1954

UNITED STATES OF AMERICA, APPELLANT

v.

LESLIE SALT COMPANY, APPELLEE

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, SOUTHERN DIVISION

Opinion

Filed December 16, 1954

Before HEALY and BONE, Circuit Judges, and DRIVER, District Judge

HEALY, Circuit Judge.

This is a suit to recover taxes exacted under 26 U. S. C. A. §§ 1800 and 1801.

Section 1801 in material part provides: "Corporate securities. On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents."

The transactions in question were two loans negotiated by the taxpayer in 1949 with insurance companies in amounts of

$1,000,000 and $3,000,000, evidenced in each instance by a non-negotiable promissory note for the full amount maturing in 15 years. Underlying each note was an agreement on the part of the borrower containing restrictions designed for the protection of the lender. No interest coupons were attached to the instruments. They were not on vellum or parchment nor were
141 they engraved, and the trial court found that they were not issued in registered form. The latter finding was not protested in the government's opening brief or in the oral argument of its counsel. The court held that the instruments were not of the type designated by the statute and are not subject to stamp tax thereunder. The opinion of the court is reported in 110 F. Supp. 680.

We are not prepared to say that the decision is wrong. There is no satisfactory evidence that Congress intended to tax instruments of this character—certainly none that it did so in anything approaching clear language. It is altogether likely that had Congress foreseen the development of corporate financing by means of large long-term placement loans like these it would not have repealed outright the statutory tax it had imposed during the first World War on promissory notes, but would have modified the statute to conform with the development. Congress has since had abundant opportunity to legislate on the subject but has not seen fit to do so. We can not but feel that in the considerable number of instances where courts have upheld exactions of the tax in situations analogous to the present they have invaded a field belonging exclusively to Congress.

In going one way or the other the judges have frequently relied on distinctions which appear to us to be without difference, mainly on whether the loan was negotiated with an insurance company or whether it was negotiated with a commercial bank. We may add that subsequent to the opinion below several decisions have come down, heading, as was inevitable, in all directions. The chief of these more recent efforts is the Second Circuit case of Niles-Bement-Pond Co. v. Fitzpatrick, 213 F. 2d 305. There the court, in holding for the taxpayer, wrestled with the unpleasant if not impossible task of distinguishing an earlier opinion of its own. Fortunately we are confronted with no problem of that nature.

Affirmed.

[File endorsement omitted.]

142 In United States Court of Appeals for the Ninth Circuit

No. 13873

UNITED STATES OF AMERICA, APPELLANT

v.

LESLIE SALT COMPANY, APPELLEE

Judgment

Filed and entered December 16, 1954

Appeal from the United States District Court for the Northern District of California, Southern Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Northern District of California, Southern Division, and was duly submitted.

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is affirmed.

[File endorsement omitted.]

143 [Clerk's certificate to foregoing transcript omitted in printing.]

144 Supreme Court of the United States

[Title omitted.]

Order extending time to file petition for writ of certiorari

Upon consideration of the application of counsel for petitioner,

It is ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby extended to and including May 14, 1955.

Wm. O. Douglas,
WM. O. DOUGLAS,
Associate Justice of the Supreme Court of the United States.

Dated this 3d day of March 1955.

Supreme Court of the United States

No. 793, October Term, 1954

[Title omitted.]

Order allowing certiorari

Filed June 6, 1955

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE 1955

No. — ~~703~~ 74

In the Supreme Court of the United States

October Term, 195~~4~~ 5

United States of America, petitioner

v.

Leslie Salt Co.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

SIMON E. SOBELOFF,
Solicitor General,
Department of Justice,
Washington 25, D. C.

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

LESLIE SALT CO.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW

The District Court's opinion (R. 18-20) is reported at 110 F. Supp. 680. Its findings of fact and conclusions of law (R. 29-33) are not reported. The opinion of the Court of Appeals (Appendix, *infra*, pp. 1a-3a) is reported at 218 F. 2d 91.

JURISDICTION

The judgment of the Court of Appeals (Appendix, *infra*, p. 3a) was entered on December 16,

1954. By order of Mr. Justice Douglas, dated March 3, 1955, the time for filing a petition for a writ of certiorari was extended to and including May 14, 1955 (Appendix, *infra*, p. 4a). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

The taxpayer borrowed $4,000,000 from two insurance companies under identical loan agreements which provided for repayment over a period of fifteen years, imposed extensive conditions and limitations upon the borrower, and granted other privileges and benefits to the lenders for the protection of their investments. The question presented is whether such instruments are subject to the documentary stamp tax imposed by Sections 1800 and 1801 of the Internal Revenue Code of 1939 on "all bonds, debentures, or certificates of indebtedness issued by any corporation * * *."

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

Sec. 1800. IMPOSITION OF TAX:

There shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in sections 1801 to 1807, inclusive, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of

them, are written or printed, the several taxes specified in such sections.

(26 U.S.C. 1952 ed., Sec. 1800.)

Sec. 1801 [As amended by Section 1 of the Revenue Act of 1939, c. 247, 53 Stat. 862; Section 209 of the Revenue Act of 1940, c. 419, 54 Stat. 516; and Section 521(a)(3) of the Revenue Act of 1941, c. 412, 55 Stat. 687]. CORPORATE SECURITIES.

On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents * * *.

(26 U.S.C. 1952 ed., Sec. 1801.)

Treasury Regulations 71 (1941 ed.):

Sec. 113.50. *Scope of Tax.*—Section 1801 imposes a tax upon the issue by any corporation of bonds, debentures, certificates of indebtedness, and all instruments, however termed, with interest coupons or in registered form and known generally as corporate securities. Every renewal of the above described instruments is taxable as a new issue.

* * * * *

Sec. 113.55. *Issues Subject to Tax.*—Ordinarily, a corporate instrument styled a bond, debenture, or certificate of indebtedness is subject to the tax. However, the taxability of an

instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc. Hence, an instrument, however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such. Similarly, an instrument issued with interest coupons, or with provision for registration, and coming within the class known generally as corporate securities will be held subject to the tax regardless of the name by which it may be called.

STATEMENT

In 1948, the Leslie Salt Company, a California corporation (the taxpayer), owed approximately $2,000,000 to certain banks. (R. 46-47.) In order to fund, extend, and increase the amount of the loans, and to obtain needed working capital, it negotiated a $4,000,000, 15-year loan from Pacific Mutual Life Insurance Company and Mutual Life Insurance Company of New York, Pacific Mutual furnishing $1,000,000 and Mutual of New York contributing $3,000,000, pursuant to separate but identical loan agreements (R. 18, 45, 85, 93-133) executed under date of February 1, 1949. To evidence this loan the taxpayer executed two instruments, also dated February 1, 1949,[1] identical ex-

[1] Under date of February 15, 1949, the closing date under the agreement, the taxpayer also executed a separate "Certificate" pursuant to each loan agreement (R. 44, 45, 85, 90-93) purporting to certify that there had been no adverse changes in its condition since execution of the agreement.

cept for amount and name of payee (R. 44, 45, 85, 87-89), denominated "$3\frac{1}{4}$% Sinking Fund Promissory Note Due February 1, 1964," in which, for value received, the taxpayer promised to pay to the payee named therein, on February 1, 1964, the principal amount, and to pay on August 1 and February 1 in each year interest at the rate of $3\frac{1}{4}$% per annum on the unpaid balance. Each note recited that it was one of one or more such notes, each of the denomination of $1,000 or a multiple thereof, made or to be made by the taxpayer in an aggregate principal amount of $4,000,000, all maturing on February 1, 1964, and bearing interest payable at the same rate and on the same dates. The note also provided that the holder, at his option, might surrender it for exchange at the office of the taxpayer and without expense receive therefor a note or notes in authorized denomination, dated as of the date to which interest had been paid on the original note.

Each payment in reduction of principal was to be recorded on the note, and it was further specified that (R. 88-89)—

> This Note is issued under and is entitled to the benefits of the provisions of an Agreement of the Company dated February 1, 1949, with respect to the Notes, a copy of such Agreement being on file at the principal office of the Company. As provided in said agreement the Notes may be prepaid prior to maturity at the option of the Company. As further provided in said agreement, the Notes are en-

titled to the benefits of the sinking fund provided for therein and are subject to prepayment through the operation of such sinking fund. In case an Event of Default, as defined in said agreement, has occurred, the principal of the Notes may be declared or may become due and payable in the manner, at the time, and with the effect provided in said Agreement.

The two separate but identical loan agreements, dated February 1, 1949, are lengthy and detailed instruments, one of which is reprinted at pages 93-133 of the printed record. In summary, by Section 1 of the agreement (R. 93-94) the taxpayer agreed to authorize the issue of two promissory notes in the aggregate principal amount of $4,000,000, to bear interest at 3¼%, to be dated February 1, 1949, and to mature February 1, 1964. Subject to the terms and conditions of the agreement, the taxpayer agreed to "sell," and the insurance companies agreed to "purchase" from the taxpayer as of the "closing date," a note in the principal amount at a "purchase price" equal to 100 per cent of the principal amount plus interest from February 1, 1949, to the closing date, delivery to be made at the taxpayer's San Francisco office upon payment of the purchase price. Section 2 (R. 95-96) recorded delivery to the lender of taxpayer's balance sheets for 1944-1948 and other materials describing taxpayer's business and properties, and contained representations by the tax-

payer as to its past earnings and financial condition. Section 3 (R. 96-100) enumerates the conditions under which the lenders agreed to "purchase" the notes, the more important of which were (1) that the lenders should receive the opinion of legal counsel that the transaction was exempt under the Securities Act of 1933, c. 38, 48 Stat. 74 (15 U.S.C., 1952 ed., Sec. 77a, *et seq.*); (2) that it was not necessary in connection with such purchase to qualify an indenture under the Trust Indenture Act of 1939, c. 411, 53 Stat. 1149 (15 U.S.C. 1952 ed., Sec. 77aaa, *et seq.*); and (3) that since the purchaser was acquiring the note for investment and not with a view to distribution, if in the future the purchaser should deem it expedient to sell the note or any notes which might be issued in exchange therefor, such sale would be an exempt transaction under the Securities Act of 1933, as amended, and would not of itself require registration of the note or such new notes, although such registration would be required as a condition of any distribution by underwriters, as defined in that Act, if at the time of sale the lender controlled the taxpayer.

Section 4 (R. 100-102) stated that the agreement was made on the representation of the purchaser that it was acquiring the note for its own account and not with a view to, or for sale in connection with, the distribution thereof. However, recognizing the unqualified right of the purchaser to dispose of its property, the section further provided that so long as the purchaser held a note or notes

of the aggregate principal amount of $300,000 or more the taxpayer would, upon receipt of written request, execute and deliver at its own expense a trust indenture providing for the issue thereunder of new 3¼% Sinking Fund Notes of the taxpayer due February 1, 1964, limited to the principal amount of notes unpaid at the date of execution of the agreement, bearing interest at the rate and entitled to the substantive benefits of the original notes. The taxpayer agreed, upon execution of such a new indenture, to issue new notes of the same or a different authorized denomination or denominations ($1,000 or a multiple thereof) either in registered form without coupons or in coupon form, and in printed or in fully engraved form, at the request of the lender, and bearing interest from the date to which interest had been paid on the surrendered note or notes, the taxpayer to bear all expenses in connection therewith, including "all stamp and other taxes" except transfer taxes.

Section 5 of the loan agreement (R. 102-105) contains the sinking fund and prepayment provisions. By paragraph 1 of that section the taxpayer is required to make "Fixed Sinking Fund Payments" annually, beginning February 1, 1951, in the amount of $285,000, without premium. Paragraph 2 provides that on each Fixed Sinking Fund Payment date the taxpayer, at its option and upon giving prior written notice, "may call for prepayment," without premium, a further principal amount of the notes equal to $285,000, provided such payment is made from earnings or

proceeds of liquidation of assets, and not from other sources. Paragraph 3 provides for "Optional Prepayments" upon written notice by the taxpayer not less than 30 days or more than 60 days prior to the date of such prepayment, either of the entire unpaid balance of principal or any part thereof not less than $50,000, with interest to the date of prepayment, plus graduated premium ranging from 3% if prepaid in the 12 months period ending January 31, 1950, to 1/4% if prepaid in the 12 months period ending January 31, 1963, and none if prepaid in the 12 months period ending January 31, 1964. Notation is to be made on the notes of any payment made in reduction of principal. (Par. 5.). All such payments of principal are to be allocated among the several noteholders, if more than one, in proportion to the amounts held by them. (Par. 6.)

By Section 6 of the loan agreement (R. 105-110) the taxpayer covenants that so long as any note or notes issued thereunder are outstanding the taxpayer and its subsidiaries will promptly pay all taxes, assessments, governmental charges, etc.; will keep their respective properties in good repair, working order and condition, and make all needed and proper renewals, replacements, extensions, betterments and improvements for the advantageous conduct of their business; will keep full and accurate business records; will reflect in their financial statements proper reserves for depreciation, depletion, obsolescence, accruals for federal and all other taxes, and all other appropriations to re-

serves which should be made in accordance with sound accounting practices; will keep all of their plants, properties, and inventories of an insurable character adequately insured; and furnish all financial statements and compliance certificates as therein provided.

By Section 7 of the loan agreement (R. 110-124) the taxpayer agrees in detail for itself and its subsidiaries that they will not create, assume, or incur in any manner any additional indebtedness except as necessary in the ordinary conduct of their business; will not mortgage, encumber, or dispose of any of their properties without adequate consideration; will not declare dividends or make distributions, with certain exceptions which would not affect the security of the loan; will maintain a net working capital at all times of at least $1,000,000; will not assume any secondary liability by guarantee or otherwise; and will limit investments, loans, and advances to the extent specified. Section 8 (R. 121-126) defines certain terms used in the loan agreement, and Section 9 (R. 126-128) enumerates the events which would amount to a default on the part of the taxpayer and make the unpaid balance of the loan immediately due and payable.

The Commissioner of Internal Revenue assessed a documentary stamp tax against the taxpayer in the amount of $4,400 pursuant to Sections 1800 and 1801 of the Internal Revenue Code of 1939 (*supra*, pp. 2-3) with respect to its issuance of the above-described notes. The tax was paid under protest

and the taxpayer filed a timely refund claim. (R. 41-42.) The Commissioner rejected the refund claim (R. 134-137) on the ground that by their terms the instruments here involved represented a method of financing similar to that accomplished through the medium of a public issuance of investment securities under an indenture; that the instruments were issued by the taxpayer as a corporate borrower to obtain money for use in its business under conditions similar to the sale of bonds, debentures, or other investment securities; that the fact the borrowing was effected through one or more lenders, rather than the general public, was immaterial to the question at issue; and that, considering all the circumstances, the instruments in question were "debentures" within the stamp tax provisions. The District Court (R. 18-20, 29-33) held that the instruments were not subject to the documentary stamp tax, and the Court of Appeals affirmed (Appendix, *infra*, pp. 1a-4a).

REASONS FOR GRANTING THE WRIT

The problem of determining the nature of the "debentures" subject to the stamp tax provisions here involved has led to a series of diverse and conflicting decisions in the lower courts. We believe that long-term instruments of the type in this case, imposing elaborately detailed restrictions upon the borrower and effecting in practical economic terms the kind of capital financing traditionally achieved through the issuance of debentures, are squarely within the class to which the stamp tax applies.

We submit, in any event, that with over a hundred cases pending, with many more to be anticipated from rejection of current refund claims; and in view of the increasing prevalence of financing by means of arrangements like those presented here, the problem is one which should be resolved by this Court.

1. The stamp tax in issue is imposed by Sections 1800 and 1801 of the Internal Revenue Code of 1939 (*supra*, pp. 2-3) upon "all bonds, debentures, or certificates of indebtedness issued by any corporation * * *." As originally enacted in the Act of October 22, 1914, c. 331, 38 Stat. 745 (Section 5, p. 753, and Schedule A, p. 759), this statute also levied a tax upon "promissory notes" (38 Stat. at 760). But "promissory notes" were eliminated by the Revenue Act of 1924, c. 234, 43 Stat. 253, 333, Schedule A of Title VIII.[2] And so in the instant case, as in a host of similar cases, the question has been put in terms of whether instruments evidencing long-term loans of large amounts, under agreements imposing extensive restrictions upon the borrower for the lender's protection, are "promissory notes" (exempt from the stamp tax) or "debentures" (subject to the tax).

The decisions, as the court below observed (Ap-

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[2] The history of the Code provisions here involved is reviewed in the majority opinion of Judge Harlan in *Niles-Bement-Pond Co.* v. *Fitzpatrick*, 213 F. 2d 305 (C.A. 2). See, also, *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593, 595 (C.A. 2), certiorari denied, 332 U.S. 810; *Stuyvesant Town Corp.* v. *United States*, 111 F. Supp. 243, 246-247 (C. Cls.), certiorari denied, 346 U.S. 864.

pendix, *infra*, p. 3a), have headed "in all directions." To select only two from the considerable number of divergent results in the lower courts, there is a square conflict between the instant decision and *Commercial Credit Co.* v. *Hofferbert*, 188 F. 2d 574 (C.A. 4), affirming *per curiam* 93 F. Supp. 562 (D. Md.). The undisputed facts in these two cases are the same in all material respects. In both, the instruments in question evidenced large long-term loans from insurance companies and were called "notes." The instruments in each case referred specifically to a contemporaneous agreement imposing restrictions and limitations upon the borrower for the protection of the lender. In both cases the lender could require issuance of the borrower's obligations in smaller denominations subject to substantially the same terms as those contained in the original agreement. See 93 F. Supp. at 562-563; *supra*, pp. 5-10. Contrary to the decision below, the courts in the *Commercial Credit* case concluded that there was "no difficulty in finding that the note read in connection with the Agreement * * * constituted a corporate debenture of the Commercial Credit Company." *Id.* at 565, affirmed on the district court opinion, 188 F. 2d 574.

Other decisions bear out the observation of the court below (Appendix, *infra*, p. 2a) that the contrariety of results reflects reliance upon distinctions which make no real difference. Compare, for example, the majority and dissenting opinions in *Niles-Bement-Pond* v. *Fitzpatrick*, 213 F. 2d 305

(C.A. 2). There the majority, reversing the district court and holding the instruments in question non-taxable, distinguished its earlier decision in *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593, certiorari denied, 332 U.S. 810, as well as *Commercial Credit Co.* v. *Hofferbert*, *supra*, largely on the ground that the lender was a bank rather than an insurance company.[3] Rejected by the court below in the instant case,[4] that distinction was criticized in the dissent of Judge Clark as emphasizing the character of the lender rather than the needs of the borrower and the nature and purposes of the loan. The criticism is, in our view, justified. More importantly, it reflects the need for authoritative guidance which makes review by this Court necessary and appropriate.

We had supposed earlier that the varying decisions in this area could somehow be reconciled in terms of variations in the factual composites they presented. On this view, we refrained from

[3] See also *Curtis Publishing Co.* v. *Smith*, 124 F. Supp. 508, 513 (E.D. Pa.), affirmed, April 25, 1955 (C.A. 3, No. 11,504), 1955 P-H Vol. 4, ¶ 72,636; cf. *United States* v. *General Shoe Corp.*, 117 F. Supp. 668 (M.D. Tenn.), pending on taxpayer's appeal to the Sixth Circuit; *S. S. Pierce Co.* v. *United States*, 127 F. Supp. 396 (D. Mass.), pending on taxpayer's appeal to the First Circuit. And compare *Sharon Steel Corp.* v. *United States*, 1955 CCH, ¶ 49,107 (W.D. Pa.) (instrument evidencing loan from insurance company a taxable "debenture"), with *Follansbee Steel Corp.* v. *United States*, 1955 CCH, ¶ 49,108 (W.D. Pa.) (instrument evidencing bank loan non-taxable "promissory note"), both decided by District Judge Willson on March 22, 1955.

[4] As we have noted, the lenders here were insurance companies, a fact which, if it were material, would assimilate this case to *General Motors Acceptance* rather than *Niles-Bement-Pond*.

seeking certiorari in such cases as *Belden Mfg. Co. v. Jarecki*, 192 F. 2d 211 (C.A. 7); *United States v. Ely & Walker Dry Goods Co.*, 201 F. 2d 584 (C.A. 8); *Allen v. Atlanta Metallic Casket Co.*, 197 F. 2d 460 (C.A. 5); and *Niles-Bement-Pond v. Fitzpatrick*, *supra*; and we opposed certiorari in *Stuyvesant Town Corp. v. United States*, 111 F. Supp. 243 (C. Cls.), certiorari denied, 346 U.S. 864. It has become apparent, however, that the differences between the decisions upholding the stamp tax [5] and those denying its application [6] are differences as to the legal definition of "debentures" and "certificates of indebtedness" as these terms are used in the stamp tax statute. We now believe that the importance of the problem (see p. 18, *infra*) warrants this Court's intervention.

2. It is the position of the Government that instruments evidencing long-term loans which contain, directly or by reference to a contemporaneous agreement, detailed restrictions on the borrower for the lender's benefit come within the statute as "debentures" or "certificates of indebtedness." This view, we think, takes proper

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[5] *General Motors Acceptance Corp. v. Higgins*, *supra*; *Commercial Credit Co. v. Hofferbert*, *supra*; *Gamble-Skogmo, Inc.* v. *Kelm*, 112 F. Supp. 872 (D. Minn.); *Kobacker & Sons Co. v. United States*, 124 F. Supp. 211 (N.D. Ohio); *United States v. General Shoe Corp.*, *supra*; *S. S. Pierce Co. v. United States*, *supra*; *Stuyvesant Town Corp. v. United States*, *supra*.

[6] *Niles-Bement-Pond Co. v. Fitzpatrick*, *supra*; *Belden Mfg. Co. v. Jarecki*, *supra*; *United States v. Ely & Walker Dry Goods Co.*, *supra*; *Allen v. Atlanta Metallic Casket Co.*, *supra*; *Shamrock Oil & Gas Co. v. Campbell*, 107 F. Supp. 764 (N.D. Texas); *Curtis Publishing Co. v. Smith*, *supra*.

account of the fact that this type of instrument has become an increasingly familiar device for the long-term capital financing of corporations.[7] Indeed, it was already true at the turn of the century that the practice of printing the entire loan agreement as part of the debenture itself had been largely abandoned in favor of issuing a shorter form of debenture and incorporating by reference the terms of the contemporaneous agreement under which the loan was made.[8] This development had preceded the enactment of the stamp tax statute in 1914 and, of course, the elimination of "promissory notes" in 1924. *Supra*, p. 12.

Neither the statute nor the Treasury Regulations issued thereunder have attempted to define the term "debentures" as used in the statute, but it is clear from dictionary definitions and textbook discussion that the term includes instruments

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[7] See *Commercial Credit Co.* v. *Hofferbert*, *supra;* 2 Dewing, *Financial Policy of Corporations*, p. 1107 (5th ed. 1953), and citations in footnote 5; Jacoby & Saulnier, *Business Finance & Banking*, p. 104 (1947); American Institute of Banking, *Credit Administration*, pp. 324-325 (1949); Prochnow, *Term Loans and Theories of Bank Liquidity*, pp. 22, 141-147 (1949); House Hearings Before a Subcommittee of the Committee on Interstate and Foreign Commerce, Part 2, 82d Cong., 2d Sess., May 20 and 21, 1952; Securities & Exchange Commission, *Privately Placed Securities—Cost of Flotation* (published under date of September 2, 1952, Government Printing Office, Washington, D. C.); Holthausen, *Term Lending to Business by Commercial Banks in 1946*, Federal Reserve Bulletin of May, 1947, p. 498; *Stamp Tax on Promissory Notes Representing Term Loans and Private Placements*, 54 Col. L. Rev. 428 (1954).

[8] See 1 Dewing, *Financial Policy of Corporations*, pp. 226, 228-230 (5th ed., 1953).

evidencing long-term capital loans of the character here involved,[9] and that what was repealed in 1924 was the tax which covered notes used customarily in day to day commercial transactions of a short time credit character. See *General Motors Acceptance Corp.* v. *Higgins, supra*, p. 595; *S. S. Pierce Co.* v. *United States, supra*. The language of Section 1801 is as broad and all-inclusive as the language of Section 1802 of the 1939 Code imposing a documentary stamp tax on the issuance or transfer of shares of stock or other interests in a corporation, and of the latter section this Court said in *Raybestos-Manhattan Co.* v. *United States*, 296 U.S. 60, 63: "The reach of a taxing act whose purpose is as obvious as the present is not to be restricted by technical refinements." See also *Pennsylvania Co. for Insurances, Etc.* v. *Rothensies*, 146 F. 2d 148, 152 (C.A. 3); *Stuyvesant Town Corp.* v. *United States, supra*. Compare *Goodyear Co.* v. *United States*, 273 U.S. 100; *Founders General Co.* v. *Hoey*, 300 U.S. 268; *Motter* v. *Bankers Mortgage Co. of Topeka, Kan.*, 93 F. 2d 778, 779-780 (C.A. 8). Here, similarly, we submit, the purpose of Congress reaches corporate obligations like the ones in this case, elaborate instruments for long-range capital financing which are readily and

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[9] See *General Motors Acceptance Corp.* v. *Higgins, supra*, p. 596; *Commercial Credit Co.* v. *Hofferbert, supra*, p. 565; 6 *Encyclopaedia Brittanica*, p. 144 (1953); V *Encyclopaedia of the Social Sciences*, pp. 29-30 (1935 ed.); Hastings Lyon, *Corporations and Their Financing*, p. 242 (1938); 1 Dewing, *Financial Policy of Corporations*, pp. 226, 228-230 (5th ed., 1953); Mead, *Corporation Finance*, pp. 284-285 (5th ed., 1925).

appropriately described as "debentures" rather than mere "promissory notes."

3. The problem presented is an important one. The records of the Internal Revenue Service show that there are now 109 cases pending in the courts involving this issue; and that the total amount of taxes involved in these cases approximates $960,000. In addition, a survey has been made of nine District Directors' offices disclosing that in those offices alone there are 142 claims for refund involving this question which are being considered or have been rejected, and that these claims for refund involve taxes in excess of $1,700,000.

Moreover, the problem will continue under the Internal Revenue Code of 1954, in which both the statutory provisions and the legislative history evince a purpose to carry forward without change the pertinent portions of the 1939 Code. See Sections 4311-4315 and 4381 of the 1954 Code; H. Rep. No. 1337, 83d Cong., 2d Sess., p. A325; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 482-483. Faced with the present contrariety of judicial opinion, the Internal Revenue Service lacks authoritative guidance in considering the host of claims already pending and others which will inevitably be filed. A ruling by this Court is needed to resolve this uncertainty.

CONCLUSION

It is respectfully submitted that this petition for a writ of certiorari should be granted.

SIMON E. SOBELOFF,
Solicitor General.

MAY, 1955.

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 13,873 Dec. 16, 1954.

UNITED STATES OF AMERICA, APPELLANT,

vs.

LESLIE SALT COMPANY, APPELLEE

Appeal from the United States District Court for the Northern District of California, Southern Division.

BEFORE: HEALY and BONE, Circuit Judges, and DRIVER, District Judge

HEALY, Circuit Judge

This is a suit to recover taxes exacted under 26 USCA §§ 1800 and 1801.

Section 1801 in material part provides: "Corporate securities. On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents. . . :"

The transactions in question were two loans negotiated by the taxpayer in 1949 with insurance companies in amounts of $1,000,000 and $3,000,000, evidenced in each instance by a non-negotiable promissory note for the full amount maturing in 15 years. Underlying each note was an agreement on the part of the borrower containing restrictions

designed for the protection of the lender. No interest coupons were attached to the instruments. They were not on vellum or parchment nor were they engraved, and the trial court found that they were not issued in registered form. The latter finding was not protested in the government's opening brief or in the oral argument of its counsel. The court held that the instruments were not of the type designated by the statuite and are not subject to stamp tax thereunder. The opinion of the court is reported in 110 F. Supp. 680.

We are not prepared to say that the decision is wrong. There is no satisfactory evidence that Congress intended to tax instruments of this character—certainly none that it did so in anything approaching clear language. It is altogether likely that had Congress foreseen the development of corporate financing by means of large long-term placement loans like these it would not have repealed outright the statutory tax it had imposed during the first World War on promissory notes, but would have modified the statute to conform with the development. Congress has since had abundant opportunity to legislate on the subject but has not seen fit to do so. We cannot but feel that in the considerable number of instances where courts have upheld exactions of the tax in situations analogous to the present they have invaded a field belonging exclusively to Congress.

In going one way or the other the judges have frequently relied on distinctions which appear to us to be without difference, mainly on whether the loan was negotiated wth an insurance company or whether it was negotiated with a commercial bank.

We may add that subsequent to the opinion below several decisions have come down, heading, as was inevitable, in all directions. The chief of these more recent efforts is the Second Circuit case of Niles-Bement-Pond Co. v. Fitzpatrick, 213 F. 2d 305. There the court, in holding for the taxpayer, wrestled with the unpleasant if not impossible task of distinguishing an earlier opinion of its own. Fortunately we are confronted with no problem of that nature.

Affirmed.

(Endorsed:) Opinion. Filed Dec. 16, 1954.

PAUL P. O'BRIEN,
Clerk.

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 13,873

UNITED STATES OF AMERICA, APPELLANT;

vs.

LESLIE SALT COMPANY, APPELLEE

JUDGMENT

Appeal from the United States District Court for the Northern District of California, Southern Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Northern District of California, Southern Division, and was duly submitted.

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of

the said District Court in this cause be, and hereby is affirmed.

(Endorsed:) Judgment. Filed and entered: December 16, 1954, Paul P. O'Brien, Clerk.

SUPREME COURT OF THE UNITED STATES

No. —, October Term, 1954

United States of America, petitioner

vs.

Leslie Salt Company

Order Extending Time to File Petition for Writ of Certiorari

Upon Consideration of the application of counsel for petitioner,

It Is Ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including May 14, 1955.

(S.) Wm. O. Douglas,
Associate Justice of the Supreme Court of the United States.

Dated this 3rd day of March, 1955.

☆ U. S. GOVERNMENT PRINTING OFFICE 1955 342713 1974

No. 74.

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October Term, 1955

No. 74

United States of America, petitioner

v.

Leslie Salt Co.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The District Court's opinion (R. 18–20) is reported at 110 F. Supp. 680. Its findings of fact and conclusions of law (R. 29–33) are not reported. The opinion of the Court of Appeals (R. 138–139) is reported at 218 F. 2d 91.

JURISDICTION

The judgment of the Court of Appeals (R. 140) was entered on December 16, 1954. By order of Mr. Justice Douglas, dated March 3, 1955 (R. 140), the time for filing a petition for a writ of certiorari was extended to and including May 14, 1955. The petition for a writ of certiorari was

filed on May 12, 1955, and was granted on June 6, 1955. (R. 141.) The jurisdiction of this Court is invoked under 28 U. S. C. 1254 (1).

QUESTION PRESENTED

The taxpayer obtained $4,000,000 from two insurance companies under identical agreements which provided for repayment over a period of fifteen years, and imposed extensive conditions and limitations upon it. The question presented is whether the two "3¼% Sinking Fund Promissory Notes" issued in connection with this transaction are subject to the documentary stamp tax imposed by Sections 1800 and 1801 of the Internal Revenue Code of 1939 on "all bonds, debentures, or certificates of indebtedness issued by any corporation * * *."

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

> SEC. 1800. IMPOSITION OF TAX.
>
> There shall be levied, collected, and paid, for and in respect of the several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in sections 1801 to 1807, inclusive, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, the several taxes specified in such sections.
>
> (26 U. S. C. 1952 ed. 1800.)

SEC. 1801 [As amended by Section 1 of the Revenue Act of 1939, c. 247, 53 Stat. 862; Section 209 of the Revenue Act of 1940, c. 419, 54 Stat. 516; and Section 521 (a) (3) of the Revenue Act of 1941, c. 412, 55 Stat. 687]. CORPORATE SECURITIES.

On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue * * *.

(26 U. S. C., 1952 ed. 1801.)

Treasury Regulations 71 (1941 ed.):

SEC. 113.50. *Scope of Tax.*—Section 1801 imposes a tax upon the issue by any corporation of bonds, debentures, certificates of indebtedness, and all instruments, however termed, with interest coupons or in registered form and known generally as corporate securities. Every renewal of the above described instruments is taxable as a new issue.

SEC. 113.55. *Issues Subject to Tax.*—Ordinarily, a corporate instrument styled a bond, debenture, or certificate of indebtedness is subject to the tax. However, the taxability of an instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc.

Hence, an instrument, however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such. Similarly, an instrument issued with interest coupons, or with provision for registration and coming within the class known generally as corporate securities will be held subject to the tax regardless of the name by which it may be called.

* * * * *

STATEMENT

In 1948, the taxpayer owed approximately $2,000,000 to certain banks. (R. 46–47.) In order to fund, extend, and increase the amount of the indebtedness, and to obtain needed working capital, it obtained $4,000,000 from the Pacific Mutual Life Insurance Company and the Mutual Life Insurance Company of New York, Pacific Mutual furnishing $1,000,000 and Mutual of New York $3,000,000, pursuant to separate but identical agreements (R. 44–45, 85, 93–133) executed under date of February 1, 1949. To evidence this transaction the taxpayer executed two instruments, also dated February 1, 1949, one of which is printed at page 87–89 of the record.[1]

These instruments, identical except for amount and name of payee (R. 44–45, 85), were denomi-

[1] Under date of February 15, 1949, the closing date under the agreement, the taxpayer also executed a separate "Certificate" pursuant to each agreement (R. 44, 45, 85, 90–93) purporting to certify that there had been no adverse changes in its condition since execution of the agreement.

nated "3¼% Sinking Fund Promissory Note Due February 1, 1964," and stated that the taxpayer promised, for value received, to pay to the payee named therein, on February 1, 1964, the principal amount, and to pay on August 1 and February 1 of each year interest at the rate of 3¼% per annum on the unpaid balance. Each note[2] recited that it was one of several such notes, each of the denomination of $1,000 or a multiple thereof, made or to be made by the taxpayer in an aggregate principal amount of $4,000,000, all maturing 15 years thereafter on February 1, 1964, and bearing interest payable at the same rate and on the same dates. Each note also provided that the holder, at his option, might surrender it for exchange at the office of the taxpayer and without expense receive therefor a note or notes in authorized denominations, dated as of the date to which interest had been paid on the original note.

Each payment in reduction of principal was to be recorded on the note, and it was further specified that (R. 88–89)—

> This Note is issued under and is entitled to the benefits of the provisions of an Agreement of the Company dated February 1, 1949, with respect to the Notes, a copy of such Agreement being on file at the principal office of the Company. As provided

[2] Throughout this brief, the word "note" is used solely for the purpose of convenient reference, and not for the purpose of characterization.

in said agreement the Notes may be prepaid prior to maturity at the option of the Company. As further provided in said agreement, the Notes are entitled to the benefits of the sinking fund provided for therein and are subject to prepayment through the operation of such sinking fund. In case an Event of Default, as defined in said agreement, has occurred, the principal of the Notes may be declared or may become due and payable in the manner, at the time, and with the effect provided in said Agreement.

The two separate but identical agreements, dated February 1, 1949, are lengthy and detailed instruments, one of which is reprinted at pages 93–133 of the record. These agreements were expressly made part of the notes, and made binding on all succeeding holders of the notes. (R. 132.) In summary, by Section 1 of the agreement (R. 93–94) the taxpayer agreed to "sell," and the insurance companies agreed to "purchase" from the taxpayer as of the "closing date," a note in the principal amount at a "purchase price" equal to 100% of the principal amount plus interest from February 1, 1949, to the closing date.

Section 2 (R. 95–96) recorded delivery to the insurance company of taxpayer's balance sheets for 1944–1948 and other materials describing taxpayer's business and properties, and contained representations by the taxpayer as to its past earnings and financial condition.

Section 3 (R. 96–100) enumerates the conditions under which the lenders agreed to "purchase" the notes, the more important of which were (1) that the lenders should receive the opinion of legal counsel that the transaction was exempt under the Securities Act of 1933, c. 38, 48 Stat. 74 (15 U. S. C. 1952 ed., Sec. 77a, *et seq.*); (2) that it was not necessary in connection with such purchase to qualify an indenture under the Trust Indenture Act of 1939, c. 411, 53 Stat. 1149 (15 U. S. C. 1952 ed., Sec. 77aaa, *et seq.*); and (3) that since the purchaser was acquiring the note for investment and not with a view to distribution, if in the future the purchaser should deem it expedient to sell the note or any notes which might be issued in exchange therefor, such sale would be an exempt transaction under the Securities Act of 1933, as amended, and would not of itself require registration of the note or such new notes, although such registration would be required as a condition of any distribution by underwriters, as defined in that Act, if at the time of sale the lender controlled the taxpayer.

Section 4 (R. 100–102) stated that the agreement was made on the representation of the purchaser that it was acquiring the note for its own account, and not with a view to, or for sale in connection with, the distribution thereof. However, recognizing the unqualified right of the purchaser to dispose of its property, the section further provided that so long as the purchaser held

a note or notes of the aggregate principal amount of \$300,000 or more, the taxpayer would, upon receipt of a written request, execute and deliver at its own expense a trust indenture providing for the issue thereunder of new $3\frac{1}{4}\%$ sinking fund notes of the taxpayer due February 1, 1964, limited to the principal amount of notes unpaid at the date of execution of the agreement, bearing interest at the rate and entitled to the substantive benefits of the original notes. The taxpayer agreed, upon execution of such a new indenture, to issue new notes of the same or a different authorized denomination or denominations (\$1,000 or a multiple thereof) either in registered form without coupons or in coupon form, in printed or in fully engraved form, and bearing interest from the date to which interest had been paid on the surrendered note or notes, the taxpayer to bear all expenses in connection therewith, including "all stamp and other taxes" except transfer taxes.

Section 5 of the agreement (R. 102–105) contained the sinking fund and prepayment provisions. By paragraph 1 of that section the taxpayer was required to make "Fixed Sinking Fund Payments" annually, beginning February 1, 1951, in the amount of \$285,000, without premium. Paragraph 2 provided that on each fixed sinking fund payment date the taxpayer, at its option and upon giving prior written notice, "may call for prepayment," without premium, of a further principal amount of the notes equal to \$285,000, pro-

vided such payment is made from earnings or proceeds of liquidation of assets, and not from other sources. Paragraph 3 provided for "Optional Prepayments," upon written notice by the taxpayer not less than 30 days or more than 60 days prior to the date of such prepayment, either of the entire unpaid balance of principal or any part thereof not less than $50,000, with interest to the date of prepayment, plus graduated premiums ranging from 3% if prepaid in the twelve-month period ending January 31, 1950, to none if prepaid in the final twelve-month period ending January 31, 1964.

By Section 6 of the agreement (R. 105-110) the taxpayer convenanted, on behalf of it and its subsidiaries, to pay promptly all taxes, assessments, governmental charges, etc., so long as any note or notes were outstanding; to keep their respective properties in good repair, working order and condition, and make all needed and proper renewals, replacements, extensions, betterments and improvements for the advantageous conduct of their business; to keep full and accurate business records; to reflect in their financial statements proper reserves for depreciation, depletion, obsolescence, accruals for federal and all other taxes, and all other appropriations to reserves which should be made in accordance with sound accounting practices; to keep all of their plants, properties, and inventories of an insurable character adequately insured. And in paragraph 6 the taxpayer agreed

to supply future financial statements to each holder of 10% or more in principal amount of the notes, such statements to be certified by an independent public accountant selected by the taxpayer and approved by each holder of 20% or more in principal amount of the notes.

By Section 7 of the agreement (R. 110–121), the taxpayer agreed that neither it nor any of its subsidiaries would create, incur, or assume any additional indebtedness, except "Unsecured Current Liabilities" or "loans from commercial banks incurred in the ordinary course of * * * business." It also promised that it would not mortgage, encumber, or dispose of any of their properties without adequate consideration, or make any long-term leases which do not satisfy certain specified conditions; would not declare dividends or make distributions, with certain exceptions which would not affect the security of the loan; would maintain a net working capital at all times of at least $1,000,000; would not assume any secondary liability by guarantee or otherwise; would limit investments, loans, and advances to the extent specified; and would not sell, transfer or otherwise dispose of any substantial part of its assets, nor merge or consolidate with any person, except under specified conditions.

Section 8 (R. 121–126) defined certain terms used in the loan agreement; Section 9 (R. 126–128) enumerated the events which would constitute a default on the part of the taxpayer and

make the entire unpaid balance of the loan immediately due and payable; and Section 10 (R. 128-133) contained certain miscellaneous clauses, such as a provision giving the holder of any note the right to inspect the taxpayer's premises as well as its books of account, and a provision obligating the present holder of the note to mark on it any interest and principal paid prior to selling such note.

The Commissioner of Internal Revenue assessed a documentary stamp tax against the taxpayer in the amount of $4,400 pursuant to Sections 1800 and 1801 of the Internal Revenue Code of 1939 with respect to its issuance of the above-described notes. The tax was paid under protest and the taxpayer filed a timely refund claim. (R. 41-42.) This claim was rejected by the Commissioner (R. 134-137), but the district court held the instruments were not subject to the documentary stamp tax (R. 18-20, 29-33) and the court of appeals affirmed (R. 138-139, 140).

SUMMARY OF ARGUMENT

The Internal Revenue Code of 1939 imposes a stamp tax of eleven cents a hundred dollars on "bonds, debentures, or certificates of indebtedness." The taxpayer sold to two insurance companies two instruments denominated "Sinking Fund Promissory Notes" which totalled $4,000,000, had a 15-year maturity and were subject to elaborate covering agreements imposing detailed

restrictions on the taxpayer for the benefit of the investors. The issue is whether these instruments are "debentures" or "certificates of indebtedness" under the Code.

I

Since the name attached to the documents by the taxpayer cannot be determinative of their taxability, it is necessary to consider their fundamental characteristics. Both lexicographers and judges have given the word "debenture" a broad meaning, generally including all corporate indebtedness. Specifically, it has been used to distinguish unsecured obligations from bonds, and long-term instruments coupled with elaborate protective covenants from ordinary promissory notes. The instruments here in question are included within such definitions. They have terms of 15 years and the accompanying agreements provide detailed limitations on the taxpayer's activities in order to protect the insurance companies' investment.

The fact that the instruments were sold in large blocks to two insurance companies rather than distributed in smaller fractions to public investors does not alter the nature of the obligations themselves. The financing was accomplished by what is known as a "private placement," a method of obtaining capital which has become popular since the passage of the Securities Act of 1933 because of the economies and convenience

so obtained. It is today widely used. But its novelty is in the method of sale followed, not in the nature of the obligation sold. If a large number of conventional debentures were sold to the same insurance companies totalling the same amount, there would be no doubt about the applicability of the stamp tax. Yet here the buyers have the right to demand that their notes be broken up into smaller instruments and supplemented by a conventional trust indenture. Since the features of the original notes are fundamentally the same as those of the fragments which would result, it is clear that the original notes are just as truly debentures as their subdivided counterparts.

Concededly, the detailed restrictions accompanying the notes here involved were embodied in an "agreement" rather than an "indenture," the notes were printed on plain white paper rather than being engraved on tinted paper, and the trustee who normally acts as intermediary between the security holders and the issuer was eliminated. But these insignificant variations are traceable to the fact that the instruments were drafted for private placement. The differences are not fundamental and do not alter the essential character of the securities.

II

These securities are taxable not only because they are "debentures", but also because they are

covered by the phrase "certificates of indebtedness." Congress apparently used this additional comprehensive description as a catchall to apply the tax to all types of long-term corporate debt. The term, as used, is not a term of art having a technical or restricted meaning but a descriptive phrase of general application.

III

In addition to the tax on debentures and certificates of indebtedness, the Code, prior to 1924, imposed a separate tax, at a lower rate, on "promissory notes." This tax was repealed in 1924. The taxpayer advanced the argument below that the "Sinking Fund Promissory Notes" here involved are therefore exempt from tax.

However, analysis shows that the tax on "promissory notes" was intended to apply to ordinary commercial paper, not to long-term formal obligations tied in with elaborate protective covenants such as are here involved. This appears in part from the linking of the term "promissory notes" with "drafts" and "checks," and in part from the legislative history which contains several references to ordinary short-term promissory notes. Moreover, since private placements were not in extensive use at the time Congress acted on "promissory notes," the financial community at that time was not accustomed to referring to such long-term formal obligations as

"promissory notes," and therefore Congress could not have had in mind the instant type of instrument when it repealed the tax on "promissory notes."

IV

Although the courts have achieved divergent results in passing upon the taxability of long-term institutional loans, the elements which have led some courts to find them not covered are absent here. For example, in *Niles-Bement-Pond Co.* v. *Fitzpatrick,* 213 F. 2d 305 (C. A. 2), the court placed emphasis on the fact that the instruments were not marketable, as evidenced by the absence of a provision that they could be broken up into smaller pieces. In the present case, however, there is a specific provision requiring the taxpayer on request from the insurance companies to substitute instruments of smaller denominations, in registered form or with coupons attached, and supported by a standard trust indenture. In *Niles,* words such as "purchase," "sale," and "investment" were absent; here such language is used. In *Niles,* the money came from banks; here it came from insurance companies. It is therefore entirely possible to reconcile the decision we seek with the decision in *Niles* and all other Court of Appeals cases holding against taxability. However, we think that the distinctions drawn in those cases are unsound, and we rely chiefly on the

argument presented above that these instruments are taxable because they represent long-term indebtedness incorporated in a formal agreement and tied in with elaborate protective covenants. Such instruments, we believe, Congress intended to tax when it enacted Sections 1800 and 1801 of the Code.

ARGUMENT

TAXPAYER'S "NOTES", WHICH REPRESENT LONG-TERM UNSECURED CORPORATE DEBT IN A VERY SUBSTANTIAL AMOUNT INCURRED FOR CAPITAL PURPOSES AND SUPPORTED BY AN ELABORATE PROTECTIVE AGREEMENT, ARE "DEBENTURES" AND "CERTIFICATES OF INDEBTEDNESS" WITHIN THE MEANING OF SECTIONS 1800 AND 1801 OF THE INTERNAL REVENUE CODE

The sole issue in this case is whether the two "3¼% Sinking Fund Promissory Notes" issued by the taxpayer to evidence the $4,000,000 transaction with the Pacific Mutual Insurance Company and the Mutual Life Insurance Company of New York are subject to the stamp tax under Section 1801 of the Internal Revenue Code of 1939, *supra*, p. 3, which provides that a tax shall be levied—

> On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons

> or in registered form, known generally as corporate securities * * *.

Since the instruments here involved were not in registered form and did not have coupons attached (R. 31), and since they were concededly not bonds, the only question which remains[3] is whether they were "debentures" or "certificates of indebtedness."

Before considering in detail the meaning of the words "debenture" and "certificate of indebtedness" perhaps it should be emphasized at the outset that the formal designation given to the instruments by the taxpayer obviously cannot be determinative for tax purposes. See, e. g., *Belden Mfg. Co.* v. *Jarecki*, 192 F. 2d 211, 212 (C. A. 7th); *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593 (C. A. 2d), certiorari denied,

[3] Initially there was some authority to the effect that the registration or coupon requirement in the second part of Section 1801 applied to all instruments under the section (see *Bellefield Co.* v. *Heiner*, 25 F. 2d 560 (C. A. 3d)), or that the tail phrase "known generally as corporate securities" qualified everything that went before (*Wilkinson* v. *Mutual Bldg. & Sav. Ass'n*, 13 F. 2d 997 (C. A. 7th)). But these interpretations have not been adopted in any subsequent cases. On the contrary, they have been specifically rejected. *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593, 596–597 (C. A. 2d), certiorari denied, 332 U. S. 810; *Commercial Credit Co.* v. *Hofferbert*, 93 F. Supp. 562, 565–566 (D. Md.), affirmed *per curiam*, 188 F. 2d 574 (C. A. 4th); *Stuyvesant Town Corp.* v. *United States*, 111 F. Supp. 243 (C. Cls.), certiorari denied, 346 U. S. 864. See also Treasury Regulations 71, §§ 113.50 and 113.55, *supra*, pp. 3–4.

332 U. S. 810. As stated in the Regulations (Section 113.55, *supra*, pp. 3–4):

> the taxability of an instrument is not determined by the name alone but depends upon all the circumstances, such as the name, form, and terms of the instrument, etc. Hence, an instrument, however designated, having all the essential characteristics of a bond, debenture, or certificate of indebtedness is taxable as such.

By this it is not meant to suggest that the Court should decide on the basis of instruments which might have been issued, rather than on the basis of those which were used. This Court made clear in *United States* v. *Isham*, 17 Wall. 496, that stamp taxes are imposed on the documents actually used even though other documents, which would have achieved the same economic result, might entail different tax consequences. The inquiry, therefore, must turn on a comparison of the essential characteristics of the "notes" here involved with the fundamental features of "debentures" and "certificates of indebtedness" as those terms are used in the Internal Revenue Code.

A. THE WORD "DEBENTURE" AS GENERALLY DEFINED AND AS INTERPRETED BY THE COURTS INCLUDES THE "NOTES" HERE INVOLVED.

The term "debenture" has generally been given a broad meaning.[1] In England, where the term

---

[1] The term is not defined anywhere in the statute or Regulations.

originated, it has been said (*Edmonds v. Blaina Furnaces Co.*, 36 Ch. Div. 215, 219, 221 (1887)):

> The term itself imports a debt—an acknowledgment of a debt—and speaking of the numerous and various forms of instruments which have been called debentures without anyone being able to say the term is incorrectly used, I find that generally, if not always, the instrument imports an obligation or covenant to pay. This obligation or covenant is in most cases at the present day accompanied by some charge or security. So that there are debentures which are secured, and debentures which are not secured.[5]
>
> * * * * *
>
> I have seen debentures of various kinds and classes, and it is a mistake to say that to be debentures the instruments must be issued and numbered *seriatim*. I have even seen a single debenture issued to one man. * * *[6]

---

[5] In England, the term "debenture" refers to both secured and unsecured obligations, whereas in the United States it is generally used to refer to unsecured obligations only. See Badger and Guthmann, *Investment Principles and Practice* 156, fn. 9 (3d ed., 1941).

[6] See also *Levy* v. *Abercorris Slate and Slab Co.*, 37 Ch. Div. 260 (1887), to the same effect. In that case an instrument evidencing a £600 loan was held to be a debenture. And see *British India Steam Navigation Co.* v. *Commissioners of Inland Revenue*, 7 Q. B. D. 165 (1881), where the court was faced with a problem similar to that presented by the instant case—to decide whether an instrument was a debenture or a promissory note for stamp tax purposes.

And in Simonson on *Debentures and Debenture Stock* 5 (3d ed., 1902), a leading English treatise on the subject, the following definition is given:

> any instrument (other than a covering or trust deed) which either creates or agrees to create a debt in favour of one person or corporation, or several persons or corporations, or acknowledges such debt, is a debenture.[7]

In the United States, also, the term covers considerable ground.[8] Thus, in Webster's New International Dictionary (2d ed., 1949), a number of different meanings including the following are given:

> Any of various instruments issued by corporations as evidences of debt. Such instruments (often called *debenture bonds*) are generally, though not necessarily, under seal, and are usually secured by a mortgage or other charge upon property; they may be registered or unregistered. * * * In some cases the debenture is no more than an unsecured promissory note of the corporation bearing a fixed rate of interest.

The definitions found in financial texts, moreover, are equally broad and flexible. Thus, in Munn, *Encyclopedia of Banking and Finance*

[7] See also Topham, *Palmer's Company Law* 272 (19th ed., 1949); Wegenast, *Canadian Companies* 630 (1931).

[8] 2 Jones, *Bonds and Bond Securities* 9 (4th ed., 1935); Husband and Dockeray, *Modern Corporation Finance* 101 (3d ed., 1952).

167 (5th ed., 1949), the term "debenture" is defined as:

> A class term for all forms of unsecured, long term debt, whether for corporate or civil (Government, state or municipal) obligations, although it is usually applied to a certificate of debt issued by a corporation.

And in Graham and Dodd, *Security Analysis* 83, fn. 1 (2 ed., 1940), it is stated: "The term 'debenture' in American financial practice has the accepted meaning of 'unsecured bond or note.'" Again in the *Practical Handbook of Business and Finance* 169 (Rev. ed., 1936), the term is defined as follows:

> A certificate of debt issued by a corporation. Unless secured by a mortgage, it is simply a promise to pay, or in other words, a promissory note.[8]

Courts have similarly defined the term. Judge Aldrich in *S. S. Pierce Co.* v. *United States*, 127 F. Supp. 396 (D. Mass.), appeal pending, stated at page 399:

> It is to be borne in mind that a debenture is, after all, nothing but a glorified promissory note.

And Judge Chase in *General Motors Acceptance Corporation* v. *Higgins*, 161 F. 2d 593, 596 (C. A.

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[8] For further definitions, see *e. g.*, Mead, *Corporation Finance* 281 (5th ed., 1925); American Institute of Accountants, *Accounting Terminology* 45 (1931); 1 Dewing, *Financial Policy of Corporations* 226 (5th ed., 1953).

2), quotes with approval the general definitions of a number of financial writers including Lough, *Corporation Finance*, Vol. VI (1914) which states:

> In law any instrument which formally acknowledges a debt and promises payment, including any written bond secured or unsecured, is a debenture. In finance, however, the term has come to be restricted to a bond which is not secured by a lien upon any specific property. In other words, it is, for all practical purposes, simply an unsecured promissory note running for a number of years.

It is thus evident that the term "debenture" has no restricted legal meaning, but rather is a generic term for various types of corporate indebtedness.

However, when the word "debenture" is used to distinguish particular types of corporate debt obligations from others, it is applied to unsecured debt, in contrast to "bonds", and to relatively long-term formal notes, in contrast to short-term promissory notes considered as current liabilities. In 1 Dewing, *Financial Policy of Corporations* (5th ed., 1953), it is stated at pages 226, 229–230:

> There is a large class of straight credit obligations unsecured by any direct pledge of specific property. They are called debentures. Such obligations are merely promises to pay a certain sum of money at a given time. Prior to 1899, most deben-

ture bonds recited on their face the conditions, if any, under which they were issued and the specific covenants, if any, made by the corporation. This often necessitated lengthy bonds. More recently, however, most debentures have been issued under an agreement or indenture, in which a trust company—often called the trustee—is mentioned as an agency to supervise the execution of the covenants of the agreement.

* * * * *

Sometimes it is provided that no further debentures shall be issued. Most common, however, is the provision that no mortgages may be created on the property without including the issue of debentures within the security of the new mortgage. After the lessons of the abrupt reversal of business of 1920–21 had been borne home, a new protection in the form of restrictions on open market borrowings was inserted in many debenture bond contracts.

Two protective covenants are especially important in protecting the investor in the debenture bonds of all types of corporations, especially corporations engaged in industries having large inventories. Some restraining clause must be included in the debenture agreement which protects the holders against the unrestricted future issue of debentures having a parallel position. Of even greater importance, especially in the protective covenants of industrial debentures, are restrictions to

> prevent the uncontrolled increase in current liabilities. The restrictions must, however, be reasonable so as not to interfere with the regular course of the business. Usually the covenant requires that the corporation shall maintain a liberal margin of quick assets in excess of current liabilities including the early maturities of the debentures.[10]

Judge Chesnut recognized this use of the word in *Commercial Credit Co.* v. *Hofferbert*, 93 F. Supp. 562, (D. Md.), affirmed, 188 F. 2d 574 (C. A. 4), when he stated at page 565:

> In modern current use in financial circles the term is generally understood to represent an instrument denoting a corporate obligation issued for long term capital financing and described in a covering agreement or indenture, not creating a mortgage or lien on real or personal property, but nevertheless ordinarily containing certain agreements, covenants or restraints which, if not observed, would tend to prejudice the ability of the issuer to meet its obligations.

When the two 15-year "3¼% Sinking Fund Promissory Notes" here involved are viewed in light of the foregoing descriptions it is apparent that they have all the essential characteristics of conventional debentures. Thus, the instruments here in issue were accompanied by detailed agreements prohibiting, *inter alia*, the assumption of

[10] See also the article "Floating Debenture" in 6 Encyclopedia Britannica 147 (1948).

any additional indebtedness, save that required in the normal course of business (R. 110–111), and the creation of any "mortgage, pledge, encumbrance, lien or charge of any kind upon any of its property or assets" (R. 112). The present instruments go even further in that they restrict the payment of dividends (R. 115–116), and the making of loans and investments (R. 117–118), prohibit any merger or consolidation (R. 119–120) and require the company to maintain at all times a working capital of at least $1,000,000 (R. 116).

It is thus apparent that the instruments here involved not only fit within the generic definition of the term "debenture," *supra*, pp. 18–22, but also contain all the typical provisions characteristic of standard corporate debentures.[11]

The complicating factor in the present case is not the nature of the obligations, but the way in which they were issued, being sold to two insurance companies in large blocks rather than distributed to

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[11] Compare the characterization of instruments similar to the present ones in *S. S. Pierce Co. v. United States*, 127 F. Supp. 396, 399, fn. 7 (D. Mass.):

> Indeed, if one disregards such seeming inconsequentials as the color of the paper and the substitution of typewriting for printing, there is considerable similarity between the documents at bar and the more usual corporate debenture. Each consists of a single summary page, containing the promise to pay and incorporating by reference a more detailed set of agreements and conditions. In the one case the incorporated document is usually termed an indenture; in the case at bar it is termed a loan agreement.

the public through an underwriter. This method of sale, generally referred to as "private placement", is an increasingly prevalent practice in corporate finance and consists of the placing of large-scale long-term debt directly with institutional investors (such as banks, insurance companies and pension trusts), rather than obtaining needed capital through the public flotation of securities.[12] The transaction may be accomplished through the issuance of so-called promissory notes accompanied by elaborate agreements, as in the instant case, or it may take the form of simply placing an entire issue of securities directly with one or more institutional investors.

The principal advantages of this method of capital financing are said to be that the corporation desirous of obtaining further capital is saved the expense incident to a public issue, that it does not have to subject itself to the fluctuations of the public securities market during the protracted period prior to the effective date of the registration statement under the Securities Act of 1933, and finally, that the direct dealing between issuer and investor makes possible an agreement tailored to the special circumstances of each par-

[12] See, *e. g.*, Corey, *Direct Placement of Corporate Securities* (1951); 2 Dewing, *Financial Policy of Corporations* 1107–1122 (5th ed., 1953), and authorities there cited in footnote 5. See also 2 House Hearings Before Subcommittee of the Committee on Interstate and Foreign Commerce, 82d Cong., 2d Sess. (Part 2), *Direct Placements of Corporate Securities*.

ticular case.[13] Statistical studies of the growth of this phenomenon indicate that, while direct placements were completely insignificant quantitatively in the first quarter of the twentieth century, they have risen to a very sizeable proportion of all security offerings in recent years. In 1951, for example, 58.4% of all corporate debt issues and 44.1% of all corporate offerings were privately placed. Moreover, if railroads and public utilities which are customarily required to offer their securities by means of competitive bidding are eliminated, we find that during the period from 1948 to 1951 82.3% of all debt issues offered by manufacturing corporations were privately placed.[14]

Thus, the private placement simply constitutes another method for accomplishing precisely the same objective as the public issuance of securities[15]—to obtain capital on a long-term basis—

[13] Corey, fn. 12, *supra*, p. 142; Dewing, fn. 12, *supra*, pp. 1112–1117.

[14] Securities and Exchange Commission, *Privately Placed Securities—Cost of Flotation* 2–6 (1952).

[15] Some of the cases which have arisen under the stamp tax indicate the complete interchangeability of the two forms of financing. Thus, in *Knudsen Creamery Co. of California* v. *United States*, 121 F. Supp. 860 (S. D. Calif.) four so-called long-term notes were issued, two to a bank and two to an insurance company, in order to refinance the company's publicly issued 4½% first mortgage serial bonds and its 5½% sinking fund debentures. Similarly, in *United Air Lines* v. *United States* (N. D. Ill.), decided February 9, 1955 (1955 P-H, par. 72,567), appeal pending, the company originally intended to issue $10,000,000 of preferred stock, $25,000,000

except that it eliminates some of the formalities necessary in a public issuance, such as S. E. C. registration[16] and the use of a supervising trustee. The fact that the securities here were sold in two large units rather than many smaller ones has no significance. If the taxpayer had printed a regular set of conventional bonds or debentures and had sold the entire issue directly to the two insurance companies, there would have been no question that the stamp tax would have been applicable.[17]

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of debentures and also to obtain some short-term bank loans. However, when it was informed by its investment bankers that no more than $12,000,000 of publicly issued debentures could be floated, it obtained the rest of the funds through five-year loans from a number of banks, evidenced by so-called promissory notes accompanied by the same types of elaborate restrictions found in the instant case.

[16] It is interesting to note for present purposes that the reason why these private placements are exempt from S. E. C. registration is not that the underlying instruments are not considered "securities" but rather because of the specific "private offering" exemption in Section 4 (1) of the Securities Act of 1933, c. 38, 48 Stat. 74. See Loss, *Securities Regulation* 400–403 (1951). Of course, there is no such "private offering" exemption in the stamp tax.

[17] Professor Corey of the Harvard Business School, in his definitive study of private placements (fn. 12, *supra*), states at page 63:

> A considerable saving frequently realized in the past through direct placement was the avoidance of a United States documentary stamp tax if the security was issued in the form of notes. The ruling of the Bureau of Internal Revenue which made this possible, however, was reversed in 1947 by a court decision. [Citing *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593 (C. A. 2).]

The form of the security (notes) rather than the

Yet, in the present case the lenders have the right to have the notes broken down into small units and supplemented by a standard trust indenture (R. 100–102). The important features of the original "notes" and their fragmented "debentures" would be identical. (R. 102.)[18]

In spite of the general recognition that private placements constitute merely a change in the method of sale rather than a change in the nature of the securities offered for sale, the taxpayer's argument below was in part that these notes cannot be debentures under Section 1801 because they were not "designed for public offering" (Br. 3).[19] But there is nothing in the statute requiring a debenture to be publicly issued in order to be taxable. On the contrary, as the Court of Claims said in *Stuyvesant Town Corp.* v. *United States*, 111 F. Supp. 243, 248:

> The tax imposed by Congress by the enactment of sections 1800 and 1801 was

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method of financing relieved the issuer of the necessity of paying the tax. Thus if the security was a [conventional type of] debenture, a mortgage bond, or an equity, the tax was applicable regardless of whether the issue was placed directly.

[18] Actually, of course, the insurance companies repeatedly stated that they were purchasing these notes for investment and not for resale. (R. 94, 98, 100.)

[19] From this fallacious premise the taxpayer naturally arrives at the conclusion that a debenture must have an indenture and a trustee, must be sold through an investment banker, must be registered with the Securities and Exchange Commission, etc.

> intended to apply to an infinite number and variety of transactions whereby a corporation, through the issuance of certificates and securities, obtained the necessary funds with which to carry out its corporate functions.

And, as pointed out, *supra*, pp. 28–29, the term debenture is not necessarily restricted to one of a large series, and there can be just one debenture issued to one person.[20] There is thus no valid reason why the form of the transaction should lead to such significantly different tax consequences. Cf. *Griffiths* v. *Commissioner*, 308 U. S. 355, 357–358; *Helvering* v. *Lazarus & Co.*, 308 U. S. 252, 255. See also *Raybestos-Manhattan Co.* v. *United States*, 296 U. S. 60, 63: "The reach of a taxing act whose purpose is as obvious as the present is not to be restricted by technical refinements."

The court below based its decision largely on the fact that (R. 139):

> There is no satisfactory evidence that Congress intended to tax instruments of this character—certainly none that it did so in anything approaching clear language. It is altogether likely that had Congress foreseen the development of corporate financing by means of large long-term placement loans like these it would not have

[20] For a case outside of the stamp tax field dealing with such a debenture, see *Keeley* v. *Associated Gas & Electric Co.*, 155 Misc. 146.

> repealed outright the statutory tax it had imposed during the first World War on promissory notes, but would have modified the statute to conform with the development.

But this view, it is respectfully submitted, assumes that simply because a new kind of financing was here utilized, the instruments involved were novel too. On the contrary, as we have shown above, only certain unimportant variations in the form of the instruments and in the details of their protective provisions result from the fact that the securities were the subject of a private placement rather than a public offering. Thus two insurance companies dealing directly with the issuer do not need the protection of engraved certificates on special paper in order to prevent forgery. And since there are, at least originally, only two obligees, the interposition of a trustee to represent them can be dispensed with. Finally, since in their original form the notes are too large for ready negotiation, and are not intended for resale, the notes need not be made negotiable nor be registered. But these are not fundamentals, and variations in them do not change the essential character of the instruments.

In the end, therefore, we return to the proposition that despite the nomenclature applied to these instruments, despite the method by which they were sold, and despite minor variations from traditional publicly distributed securities, they

are formal, long-term, unsecured corporate obligations incurred for capital purposes and supported by elaborate protective covenants, so that, whatever else the word "debentures" may encompass, it certainly covers these instruments.

B. IN ADDITION TO BEING TAXABLE AS "DEBENTURES", THE INSTRUMENTS HERE INVOLVED ARE COVERED BY THE COMPREHENSIVE PHRASE "CERTIFICATES OF INDEBTEDNESS."

Apparently aware of the changing terminology of the securities markets, Congress applied the stamp tax not only to "bonds" and "debentures" but also to "certificates of indebtedness issued by any corporation." Internal Revenue Code, Section 1801, *supra*, p. 3. There is no evidence that Congress intended to use "certificates of indebtedness" as a term of art to describe any specific or particular type of corporate indebtedness. It appears rather to have been used as a non-technical comprehensive description that would cover all instruments evidencing debt obligations which might somehow not be embraced within the other terms. A similar device was used by Congress in the Securities Act of 1933, 15 U. S. C. 77b (1), where it listed "bond, debenture, evidence of indebtedness." See Loss, *Securities Regulation* 318 (1951).

The term "certificate of indebtedness" is not a common one in corporate finance. It has various limited and very narrow uses in describing particular types of instruments to which Congress obviously could not have intended the statute to

be restricted. Thus, it sometimes refers to a certificate issued by the United States Treasury for current cash requirements and used by the purchaser to meet subsequent tax payments. 31 U. S. C. 754; 26 U. S. C. 3657. Again, trustee's or receiver's certificates have at times been referred to as certificates of indebtedness. See, *e. g.*, *Matter of Follansbee Brothers Co.*, 42 F. Supp. 448 (W. D. Pa.); *United States* v. *Powell*, 95 F. 2d 752 (C. A. 4), certiorari denied, 305 U. S. 619. And some state cases use the term to describe municipal obligations issued for emergency purposes. See, *e. g.*, *State ex rel. Stauss* v. *Cuyahoga County*, 130 Ohio St. 64. On its face the statute precludes any inference that there was a Congressional intent to limit the use of the term to these highly specialized instruments; and of course there is nothing in the legislative history to support so restricted a construction.

Moreover, there is authority for the use of "certificate of indebtedness" as a general description broadly embracing all instruments evidencing debt. In Kohler, *A Dictionary for Accountants* (1952), it is defined at page 79:

> A general term applied to a bond or other security evidencing debts owed, as distinct from a certificate of stock which represents a share in the equity.

The definition in Black's *Law Dictionary* (3d ed. 1933) at page 300 is:

> A form of obligation sometimes issued by public or private corporations having practically the same force and effect as a bond, though not usually secured on any specific property.

So also in the *Practical Handbook of Business and Finance* (Rev. ed., 1936) the phrase is defined at page 103 as "An acknowledgment of debt."

While none of the cases specifically passing on the taxability of instruments used in private placements holds directly that they are "certificates of indebtedness," at least two courts have stated that they are either debentures or certificates of indebtedness, and that it is not necessary to decide which. *Stuyvesant Town Corporation* v. *United States*, 111 F. Supp. 243, 248 (C. Cls.), certiorari denied, 346 U. S. 864; *Kobacker & Sons Co.* v. *United States*, 124 F. Supp. 211 (N. D. Ohio).[21]

The fact that Congress used this additional description of the securities it intended to tax does not, in our opinion, detract from our argument that these particular instruments are taxable as "debentures"; rather, it is suggested that Congress reinforced its primary listing of securities covered by the tax with a more general, all-embracing reference to "certificates of indebtedness.

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[21] The only case holding that such documents are not certificates of indebtedness is *General Motors Acceptance Corporation* v. *Higgins*, 161 F. 2d 593, 595 (C. A. 2), which, without discussion, relied upon a Treasury Regulation now repealed.

C. THE FACT THAT CONGRESS DEALT SEPARATELY WITH "PROMISSORY NOTES" DOES NOT DETRACT FROM THE CONCLUSION THAT THE INSTRUMENTS HERE INVOLVED ARE "DEBENTURES" OR "CERTIFICATES OF INDEBTEDNESS."

Historically, the first federal stamp tax was enacted in 1797, but was repealed again a few years later.[22] And while a stamp tax was reenacted several times subsequently for temporary periods as a wartime revenue measure,[23] it was not until 1914 that the stamp tax became a permanent institution. At that time a tax was imposed in one paragraph and at one specified rate on all "Bonds, debentures, or certificates of indebtedness," and in another paragraph at a lower rate on all "Promissory notes, except bank notes issued for circulation, * * *."[24] Following some other amendments during the years 1914–1924 in the course of which promissory notes were classed with drafts and checks,[25] the tax on these three banking instruments was repealed by Section 1100 (a) of the Revenue Act of 1924, c. 234, 43 Stat.

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[22] Act of July 6, 1797, c. XI, 1 Stat. 527, Section 1; repealed, Act of April 6, 1802, c. XIX, 2 Stat. 148, Section 1.

[23] See, *e. g.*, Act of June 13, 1898, c. 448, 30 Stat. 448, Section 6; repealed, Act of March 2, 1901, c. 806, 31 Stat. 938, Section 5, Act of April 12, 1902, c. 500, 32 Stat. 96, Section 7.

[24] Act of October 22, 1914, c. 331, 38 Stat. 745, Section 5 and Schedule A.

[25] In the Act of October 3, 1917, c. 63, 40 Stat. 300, Section 807, the tax was imposed in one paragraph (p. 321) on all "Bonds, debentures, or certificates of indebtedness" and in another (p. 323) on

> Drafts or checks payable otherwise than at sight or on demand, promissory notes, except bank notes issued for circulation, and for each renewal of the same. * * *.

253, 352, and was not later reenacted. The tax on bonds, debentures or certificates of indebtedness, meanwhile, has remained in effect since 1914, and at the time of the transactions here involved was found in Section 1801 of the Internal Revenue Code of 1939.[26]

From the fact that the stamp tax on "promissory notes" was thus repealed in 1924, the taxpayer has sought to draw the inference that the "3¼% Sinking Fund Promissory Notes" here in issue are therefore exempt from tax. This argument is unsound for a number of reasons.

To begin with, as pointed out *supra*, pp. 17–18, the mere fact that the taxpayer chose to designate the instruments here involved "Promissory Notes" does not, of course, bring them within the separate provision governing commercial banking instruments or remove them from the category of "debentures" or "certificates of indebtedness." If a corporation had designated some of its secured bonds as "notes", as indeed is often done,[27] it cannot be assumed that they would have gained the advantage of the lower tax in 1914 or exemption from all tax in 1924. Congress was taxing instruments on the basis of their char-

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[26] The tax is carried forward in Sections 4311 and 4381 of the Internal Revenue Code of 1954. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. A325; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 482–483.

[27] See Badger and Guthmann, *Investment Principles and Practice* 132, fn. 11 (3d ed., 1941).

acteristics, not their names.' And the instruments here in question are not the kind of "promissory notes" covered by the separate provision, but would have been then, as they are now, taxable because of their essential nature as debentures or certificates of indebtedness.

The legislative history of the various Acts is helpful although not in itself determinative. There is definite emphasis in the debate of both houses [28] on the fact that Congress, in repealing

[28] See, for example, the following statements:

Congressman Hudspeth of Texas (65 Cong. Record, Part 4, 3277):

> Does the gentleman believe that the old farmer who goes to the bank and renews his note every 90 days, as all of we farmers have to do, should pay a tax of 2 cents every time he borrows $100 * * *?

See also 65 Cong. Record, Part 4, 3279.

Congressman Burtness of North Dakota (65 Cong. Record, Part 4, 3277):

> Usually the paper cannot be extended for more than 90 days at a time, and stamps must be attached to every renewal note.

Congressman McKeown of Oklahoma (65 Cong. Record, Part 4, 3279):

> If you are going to reduce taxes, why not give the fellow who is unfortunate a chance in life? He is the man who has to pay this tax.

Senator Broussard of Louisiana (65 Cong. Record, Part 8, 8199-8200):

> The theory and the only justification that the Congress has for imposing a tax of this kind is that it shall be imposed upon anyone who has made money. The individual who makes money is taxed in this bill; so is the corporation and the partnership; but when we come to

the stamp tax on promissory notes, was motivated principally by a desire to aid the ordinary individual having a few small-denomination, 60- or 90-day notes outstanding.[29] And while it is true, as Judge (now Mr. Justice) Harlan pointed out in *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F. 2d 305 (C. A. 2), that there was also a reference to larger corporate loans and to a loan extending for a period as long as five years,[30] the fact remains that the promissory notes on which the tax was repealed were always grouped along with such short-term instruments as drafts and checks, whereas instruments designed for long-term capi-

> impose a tax upon an individual who makes a loan from a bank, I think we are absolutely overstepping all boundaries in time of peace.
>
> * * * and it is the people who borrow, the people who have no cash, upon whom this tax is imposed.

Senator McKellar of Tennessee (65 Cong. Record, Part 8, 8200):

> I think it is a nuisance tax, pure and simple. It brings in very little money, comparatively speaking, * * *. * * * and there is no reason for imposing this kind of a tax, which is exceedingly * * * irritating to the public and falls on a class of people that are not able to bear it.

[29] See also statement of L. F. Gates, House Hearings Before Committee on Ways and Means, 68th Cong., 1st Sess., *Revenue Revision, 1924*, p. 233; statement of Congressman Burtness, *id.*, p. 218; and statement of A. H. Emery, House Hearings Before Committee on Ways and Means, 65th Cong., 2d Sess., *Revenue Act of 1918*, pp. 1555–1556. Messrs. Gates and Emery both characterized the tax on promissory notes as a "nuisance" tax, and requested its repeal on that ground.

[30] 65 Cong. Record, Part 4, 3279, 3280.

tal financing (such as bonds and debentures) have always been subjected to the tax.

As explained above, the "3¼% Sinking Fund Promissory Notes" here in issue were specifically designed for private placement. This is a new method of distributing securities virtually unknown in 1914 or 1924 when Congress used the term "promissory notes" in contrast to the phrase "bonds, debentures, or certificates of indebtedness." There was then no Securities Act of 1933 and the other factors which have since given impetus to the private placement had not yet cut into the investment bankers' monopoly on securities distributions. Thus the financial community was not at that time accustomed to referring to securities involved in long-term capital financing as anything other than bonds or debentures. And Congress in using the term "promissory note" undoubtedly referred to the ordinary garden-variety I. O. U. and not to an instrument having such characteristically long-term debt features as restrictions on borrowing and dividends, and a sinking fund.[31]

It is therefore our contention that these so-called "promissory notes" are not the kind of

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[31] Further evidence of the fact that the present instrument is not an ordinary commercial promissory note can be found in the provision of the agreement prohibiting the incurring of further indebtedness similar to that here involved, but making a specific exemption for "loans from commercial banks incurred in the ordinary course of * * * business". (R. 110–111.)

ordinary commercial banking instruments on which the tax was repealed in 1924, but contain all the essential elements of long-term corporate securities, taxable in 1914, 1924 and today. The Congressional intent was to tax them for what they really are.

D. THE FACTORS RELIED ON IN SOME OF THE CASES TO SUPPORT THE CONCLUSION THAT THE INSTRUMENTS THERE INVOLVED WERE NOT TAXABLE ARE ABSENT FROM THE PRESENT CASE.

It would follow from the foregoing discussion that all instruments, no matter what denominated, evidencing large-scale, long-term loans, and accompanied by detailed agreements subjecting the borrower to extensive restrictions, are taxable under Section 1801 of the Internal Revenue Code of 1939.[32] The many courts which have considered this problem, however, have not arrived at such a unanimous conclusion.[33]

[32] See Note, 54 Col. L. Rev. 428–431.

[33] Decisions holding the instruments involved subject to the documentary stamp tax are: *General Motors Acceptance Corp. v. Higgins*, 161 F. 2d 593 (C. A. 2), certiorari denied, 332 U. S. 810; *Commercial Credit Co. v. Hofferbert*, 93 F. Supp. 562 (D. Md.), affirmed *per curiam*, 188 F. 2d 574 (C. A. 4); *Stuyvesant Town Corp. v. United States*, 111 F. Supp. 243 (C. Cls.), certiorari denied, 346 U. S. 864; *S. S. Pierce Co. v. United States*, 127 F. Supp. 396 (D. Mass.), pending on appeal to the Court of Appeals for the First Circuit—argued June 7, 1955, but being held for decision by this Court herein; *Sharon Steel Corp. v. United States* (W. D. Pa.), decided March 22, 1955 (1955 P-H, par. 72,716), on appeal to the Court of Appeals for the Third Circuit—continued pending decision herein; *United States v. General Shoe Corp.*, 117 F. Supp. 668 (M. D. Tenn.), pending on

Perhaps typical of the cases holding the instruments involved not taxable is *Niles-Bement-Pond Co.* v. *Fitzpatrick*, 213 F. 2d 305, where the Court of Appeals for the Second Circuit distinguished its own prior decision in *General Motors Acceptance Corp.* v. *Higgins*, 161 F. 2d 593, certiorari denied, 332 U. S. 810. In the *Niles* case, the taxpayer gave 29 "Promissory Notes" totalling in excess of $3,000,000 to the National

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appeal to the Court of Appeals for the Sixth Circuit—argued April 27, 1955, but being held for decision by this Court herein; *Gamble-Skogmo, Inc.* v. *Kelm*, 142 F. Supp. 872 (D. Minn.); *General Motors Acceptance Corp.* v. *Higgins*, 120 F. Supp. 737 (S. D. N. Y.); *Knudsen Creamery Co. of California* v. *United States*, 121 F. Supp. 860 (S. D. Cal.); *Kobacker & Sons Co.* v. *United States*, 124 F. Supp. 211 (N. D. Ohio). Decisions holding the instruments involved not subject to the documentary stamp tax, in addition to the instant case, are: *Niles-Bement Pond Co.* v. *Fitzpatrick*, 213 F. 2d 305 (C. A. 2); *Curtis Publishing Co.* v. *Smith*, 220 F. 2d 748 (C. A. 3), petition for writ of certiorari filed July 22, 1955, No. 254, this Term; *Allen* v. *Atlanta Metallic Casket Co.*, 197 F. 2d 460 (C. A. 5); *Belden Mfg. Co.* v. *Jarecki*, 192 F. 2d 211 (C. A. 7); *United States* v. *Ely & Walker Dry Goods Co.*, 201 F. 2d 584 (C. A. 8); *Bijou Theatrical Enterprise Co.* v. *Menninger*, 127 F. Supp. 16 (E. D. Mich.), on appeal to the Court of Appeals for the Sixth Circuit—continued pending decision herein; *United Air Lines, Inc.* v. *United States* (N. D. Ill.), decided February 9, 1955 (1955 P-H, par. 72,567), on appeal to the Court of Appeals for the Seventh Circuit; *Motor Finance Corp.* v. *United States* (D. N. J.), decided July 2, 1954 (1954 P-H, par. 72,706); *Follansbee Steel Corp.* v. *United States* (W. D. Pa.), decided March 22, 1955 (1955 P-H, par. 72,715), on appeal to the Court of Appeals for the Third Circuit—continued pending decision herein; *Shamrock Oil & Gas Co.* v. *Campbell*, 107 F. Supp. 764 (N. D. Tex.).

City Bank of New York, each note being accompanied by a detailed loan agreement of the same form as the one involved in the instant case. The notes extended over a seven-year span, maturing periodically throughout that time. Judge Harlan, writing for the majority of the court, after pointing out that the repeal of the 1924 tax on promissory notes was not dispositive of the case, concluded that the instruments there involved were not "debentures." The decision was based largely on the fact that the *Niles* notes, unlike those in the *GMAC* case, were not marketable, there being no provision entitling the lender to request the borrower to break up the large notes into smaller ones. However, the court also emphasized such factors as language of "purchase," "sale" and "redemption" in the *GMAC* case and the fact that the lenders in the *GMAC* case were largely insurance companies who had bought the notes for investment purposes. All of these factors, the court noted, were absent in the *Niles* case.

For the reasons stated in Judge Clark's dissent in the *Niles* case, we do not think that such factors as the nature of the lender (i. e., whether bank or insurance company) or the words used in the agreement should determine whether a particular instrument is or is not subject to the stamp tax. As pointed out above, pp. 18–40, it seems to us that Congress undoubtedy wanted to tax all instruments protected by elaborate convenants and utilized for the purpose of large-scale, long-term

capital financing, without regard to the particular manner in which the particular instruments were sold. Therefore, with all due respect, we believe that in light of the complete interchangeability of the various forms of financing, the lines of distinction laid down in such cases as *Niles* result in an unwarranted discrimination which Congress could have not intended.

The important point for present purposes, however, is that, wholly apart from the validity of these distinctions, the *Niles* case and all other Court of Appeals cases decided against the Government on this issue are completely consistent with a decision for the Government in the instant case.[34] Indeed, the very factors stressed by

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[34] All of the Court of Appeals cases decided against the Government, save the *Allen* case (fn. 33, *supra*), also involved loans from banks with which the taxpayer had had prior dealings, and this fact was heavily relied upon by the respective courts. Conversely, no case involving a loan solely from an insurance company, save the *Allen* case and the instant case, has been decided against the Government. The *Allen* case was a somewhat unique case in that the loan there was relatively small and was secured by a realty deed, thus in effect constituting a mortgage. See *Commercial Credit Co.* v. *Hofferbert*, fn. 33, *supra*, p. 565.

While, for the reasons indicated, *supra*, pp. 42–43, we do not agree with the distinctions laid down in such cases as *Niles*, and consequently cannot accept the basic position taken by the taxpayer in its brief in opposition in *Smith* v. *Curtis Publishing Co.*, No. 254, this Term, it is interesting to note that that brief (p. 10) also recognizes that the present case is the only one in what it calls "The *GMAC* Group" which has been decided against the Government.

Judge Harlan in the *Niles* case to distinguish the *GMAC* case all militate towards taxability here. Thus in the present case the lenders were insurance companies, the loan was clearly for investment purposes (R. 98, 100), there was a specific provision entitling the lenders to request the borrower to break up the large notes into smaller notes and even to have a regular trust indenture set up (R. 88, 100–102),[35] language of purchase and sale was used (R. 94), and a premium was payable in case of premature redemption (R. 103–104). It is thus evident that on the very tests laid down in the *Niles* and other recent cases,[36] the instruments here involved are clearly taxable.

However, even though the result we urge is consistent with the cases holding against taxability of private placements, we urge that those cases are in error and that a sounder basis for upholding the tax here is, as we argue above, that Congress intended in Section 1801 to cover all long-

[35] See the reliance placed on this provision in *Commercial Credit Co.* v. *Hofferbert*, fn. 33, *supra*, p. 566, a case completely indistinguishable from the present case, as respondent acknowledged in its brief in opposition. (Br. 6.)

[36] For a recent District Court decision emphasizing the absence of some of these same factors as a basis for arriving at the conclusion that the instruments involved were not taxable, see *United Air Lines* v. *United States*, fn. 33, *supra*. And compare *Sharon Steel Corp.* v. *United States*, fn. 33, *supra*, with *Follansbee Steel Corp.* v. *United States*, fn. 33, *supra*, decided by the same court on the same day but reaching different conclusions.

term debt obligations supported by elaborate protective covenants and that this is so regardless of the details of the papers used, the language by which the transaction was consummated or the nature of the purchaser's business. In short we urge that the instruments should be taxed according to their fundamental nature.

CONCLUSION

For the reasons stated, the decision below should be reversed.

Respectfully submitted.

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Solicitor General.

H. BRIAN HOLLAND,
Assistant Attorney General.

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SEPTEMBER 1955.

U. S. GOVERNMENT PRINTING OFFICE 1955

In the Supreme Court of the United States

October Term, 1954

No. 779

United States of America,
Petitioner,
vs.
[illegible] Co.,
Respondent.

[illegible]

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In the Supreme Court
OF THE
United States

October Term, 1954

No. 793

United States of America, *Petitioner*, vs. Leslie Salt Co. *Respondent.*	

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF FOR RESPONDENT IN OPPOSITION.

OPINIONS BELOW.

The District Court's opinion is reported at 110 F. Supp. 680. The opinion of the Court of Appeals is reported at 218 F.2d 91.

JURISDICTION.

Jurisdiction is as set forth in the Petition.

QUESTION PRESENTED

Whether two instruments issued by a borrower to two insurance companies are what they purport to be and as the District Court and Court of Appeals found—promissory notes and not subject to tax—or are said instruments "debentures" and thus subject to tax within the meaning of Section 1801 of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Petition at pp. 2-4.

STATEMENT.

In substance, the statement made by petitioner amounts merely to a purported summary of the documents involved (R. 87-133) and said documents can and do speak for themselves. Entirely omitted from petitioner's statement is any discussion of the testimony of the witnesses called, this testimony describing in detail the differences between "debentures" and "promissory notes" of the type here involved as those terms are used and understood in the business and financial community. Our statement will attempt to cure this omission.

On examination of the whole record, it is apparent that promissory notes on the one hand and debentures on the other have some similarities but that they also have significant differences. The key to the differences lies in the conflicting purpose each instrument is de-

signed to serve. A debenture is designed for public offering and for easy resale if the purchaser so desires. Its terms, appearance and methods of sale are designed to accomplish this result. A non-negotiable promissory note (such as the two involved in the instant case) by its very nature cannot be offered for sale to the general public, nor can such a note be readily resold. Of course it is conceivable that instruments entitled "debentures" could be offered to only one lender and that said instruments could contain all terms customarily appearing in debentures. However, this procedure would be pointless unless the buyer, in turn, contemplated resale to the investing public and wanted to avoid the necessity of retiring an old instrument and the substitution of debentures before making a public offering (R. 72).

The difference in *purpose* between a debenture and promissory note should be kept in mind in evaluating the evidence we now discuss.

First, the method of sale. Leslie Salt Co. needed more money and had one of its directors approach the two insurance companies which made the loan (R. 49). No other prospective lenders were approached, and all negotiations were carried on directly between the two insurance companies and the borrower without the services of an investment banker or other intermediary (R. 49). The two lenders took the initiative in drafting the terms of the loans, the terms were discussed, and the loans were closed in San Francisco (R. 50). By contrast, debentures are sold as other corporate securities are sold in that they are offered to the ultimate buyers through the chan-

nels of investment bankers who employ their own distribution facilities (R. 62). The investment bankers act as middlemen in that they use their capital to purchase the issue and then resell to the public (R. 62, 63). The terms involved with respect to debentures are negotiated between the borrower and buying investment banker, or, in the case of competitive bidding, they are fixed solely by the borrower. But so far as the *ultimate* lender is concerned, terms are already fixed and his sole choice is limited to buy or not to buy. The two insurance companies making the Leslie loans were not presented with such a take-it-or-leave-it proposition; here the *lenders* took the initiative in presenting terms—the exact converse to the situation present when buying a debenture.

Although the services of an investment banker may be employed in the private placement of a promissory note, its role is that of a negotiating agent and neither its capital nor its distribution facilities are employed (R. 63). The notes may be placed without the aid of an investment banker at all, which was the case with Leslie (R. 63).

Other characteristics of a debenture sale as contrasted to the sale of a promissory note are (a) a sale of debentures is customarily advertised by an accompanying circular or prospectus, (b) a prospectus is filed with the Securities and Exchange Commission if the sale is of any size, (c) it is customary to attempt to obtain clearance with various state blue sky law commissions, (d) the underwriters request an opinion of counsel as to the legality of investment by various financial institutions (R. 70-71).

After original sale, debentures are constantly bought and sold and otherwise traded in after original issuance, and public quotations are made as to the going price (R. 69-70). There is no such after-market for notes such as the present ones (R. 70), and the court will see that the lenders are acquiring the present notes for their own account and not for resale (Pl. Ex. 3, R. 45, 100).

With respect to terms and appearance, a debenture is accompanied by an indenture containing various protective provisions to protect the purchaser, and provision is made for an independent trustee to enforce the rights of the buyers as contained in the indenture (R. 61). The Leslie Salt Co. notes are accompanied by loan agreements which on their face are likewise designed to protect the lenders (R. 93). However, no trustee is created. The purpose of a trustee in connection with a debenture issue is that debenture issues are widely held and traded in, and individual debenture holders are in no position to effectively protect their rights (R. 62). When two informed lenders alone are involved, as is true with the Leslie Salt Co. loans, no trustee is needed. Protective features are usually more severe with respect to notes than for debentures (R. 61). Debenture certificates are prepared in a form to be negotiable and have the word "debenture" printed on them, or engraved, together with destrictive covenants (R. 72). None of these features appear on the Leslie Salt Co. notes.

As to amount, debentures are usually offered in units of $1,000, or multiples thereof (R. 62). It is self-evident that the relatively small denomination of debentures is again designed to facilitate a wide distribution and easy

resale, whereas notes such as the Leslie Salt Co. notes, in the amount of $1,000,000 and $3,000,000, respectively, are too high in price for such purpose.

The District Court made a finding of fact that the two promissory notes were what they purported to be and did not have the characteristics that would make them "debentures" *as said term is commonly defined* (R. 31). Accordingly, it entered judgment for respondent (R. 34-35). The judgment was affirmed by the United States Court of Appeals for the Ninth Circuit on December 16, 1954 (R. 142).

ARGUMENT.

Respondent concedes that the decision below is in conflict with the earlier result reached by the United States Court of Appeals for the Fourth Circuit in *Commercial Credit Co. v. Hofferbert*, 188 F.2d 574 (4th Cir. 1951). However, that case stands alone, has not been followed by any of the five Courts of Appeals which have subsequently considered the present problem, and appears to have lost all vitality. It is submitted that the Fourth Circuit can be relied upon to correct its earlier erroneous position when presented with a subsequent case, just as the Second Circuit has since repudiated the erroneous reasoning of its earlier opinion in *General Motors Acceptance Corp. v. Higgins*, 161 F.2d 593 (2d Cir. 1947), cert. denied, 332 U. S. 810, 92 L. Ed. 387, 68 S. Ct. 111 (1947), which case was followed by the Fourth Circuit in reaching its incorrect result. The present problem of the Internal Revenue Service referred to at page 18 of

the Petition is entirely of that body's own making. It need only follow its earlier and correct administrative interpretation of the statute, which interpretation existed from 1924 until 1947, and the weight of judicial opinion, and the problem will disappear. It is submitted that there is no need for this Court to write a regulation for the Internal Revenue Service, as Petitioner in substance urges, and that certiorari should be denied.

I. THE TREND OF JUDICIAL OPINION IS SUCH THAT THE PRESENT CONFLICT SHOULD BE RESOLVED WITHOUT NECESSITY FOR GRANTING CERTIORARI.

The effort of the Internal Revenue Service to tax promissory notes as "debentures" within the meaning of §1801 of the Internal Revenue Code of 1939 had its first origin with the unexpected success of the Government in *General Motors Acceptance Corp. v. Higgins*, 161 F.2d 593 (2d Cir. 1947), cert. denied, 332 U. S. 810, 92 L. Ed. 387, 68 S. Ct. 111 (1947). From the contents of the opinions, it would appear that the first serious contention that the notes involved in the *General Motors* case were taxable as "debentures" was made before the appellate court, since the Treasury had apparently earlier contended only that the instruments were taxable as "corporate securities" because of their appearance and the fact that they were allegedly in registered form. *General Motors Acceptance Corporation v. Higgins*, 60 F. Supp. 979, 981 (S. D. N. Y. 1945). Following its success in the *General Motors* case in somehow converting tax-free notes into taxable debentures, an effort which the Dis-

trict Court below aptly described as an attempted "feat of catalytic baptism", 110 F. Supp. at 681, the Bureau of Internal Revenue reversed its time-honored practice of regarding notes such as those involved in the instant case as non-taxable and attempted to impose a tax. It did, however, have the grace not to apply its new ruling retroactively. This change of position is reported in M. T. 32, Cum. Bull. 1948-2, page 160. We quote from a portion of said ruling as follows:

> "*The Bureau has for a considerable period of time held that an instrument termed 'note,' not in registered form and issued without interest coupons, is not subject to the stamp tax upon issuance or transfer.* Because of this long and uniform holding of the Bureau and the consequent reliance of corporations on these rulings, it has been concluded that, under the authority contained in section 3791 (b) of the Internal Revenue Code, the decision in *General Motors Acceptance Corporation v. Higgins, supra,* will not be applied retroactively, except that any tax which has been paid on the issuance or transfer of instruments falling within the scope of the decision will not be refunded." (Italics added.)

The attempted re-writing of the statute by the Bureau failed, however, to receive sustained judicial approval. It was successful in persuading a District Court in Maryland to follow its views. *Commercial Credit Co. v. Hofferbert*, 93 F. Supp. 562 (D. Md. 1950). In so doing, however, the District Court followed the erroneous reasoning of the *General Motors* case, apparently without independent analysis. This decision was affirmed by the Fourth Circuit in a per curiam opinion, 188 F.2d 574,

again without independent analysis. Since this decision was reached, however, and on more mature consideration, the Courts of Appeal for five circuits, counting the decision below, have passed on the question of whether notes similar to those in the instant case should be taxed. The result of each of said cases has been opposed to the views of petitioner. These cases, other than the one below, are as follows: *Belden Mfg. Co. v. Jarecki*, 192 F.2d 211 (7th Cir. 1951); *Allen v. Atlanta Metallic Casket Co.*, 197 F.2d 460 (5th Cir. 1952); *United States v. Ely & Walker Dry Goods Co.*, 201 F.2d 584 (8th Cir. 1953); *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305 (2d Cir. 1954); *Curtis Publishing Company v. Smith*, Supp. Vol. CCH Fed. Tax Serv. Par. 49, 114, 4 P-H 1955 Fed. Tax Serv. Par. 72, 636 (3d Cir. 1955). There have been no decisions by a United States Court of Appeals subsequent to the *Commercial Credit* case in favor of Petitioner, though on what must be regarded as a peculiar set of facts the Court of Claims has handed down a decision opposed to the taxpayer there involved. *Stuyvesant Town Corp v. United States*, 124 Ct. Cl. 686, 111 F. Supp. 243 (Ct. Cl. 1953), cert. denied, 346 U. S. 864, 98 L. Ed. 375, 74 S. Ct. 102 (1953).

It will be noted that one of the cases favorable to the taxpayer listed above, *Niles-Bement-Pond*, was decided by the same court which decided the *General Motors* case. In so doing, the Second Circuit distinguished its earlier opinion. As we will later demonstrate, the *result* of *General Motors* is not wholly in error; our objection lies solely with respect to certain unfortunate language contained in the opinion. This language was in substance

repudiated in the *Niles-Bement-Pond* case, and, it is submitted, the Fourth Circuit can also be relied on to correct its views when presented with a second case without necessity for granting certiorari in the instant case.

We should add that two cases on facts similar to those at bar, and which are adverse to the taxpayer, are now on appeal before the United States Court of Appeals for the Sixth and First Circuits, respectively, which have not previously passed on this question. These cases are *United States v. General Shoe Corp.*, 117 F. Supp. 668 (M. D. Tenn. 1953); and *S. S. Pierce Company v. United States*, 127 F. Supp. 296 (D. Mass. 1954).[1] In the event that the appellate courts fail to correct the erroneous results below in these two instances, we anticipate a greater need for certiorari, but the obvious remedy of petitioner is to seek amendment of the statute, as it has had abundant opportunities to do, if dissatisfied with the weight of judicial opinion on the subject. We urge that a grant of certiorari in the present case would be premature.

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[1] There have been three other recent decisions concerning the present issue before the district courts. These cases are *Sharon Steel Corp. v. United States*, Supp. Vol. CCH Fed. Tax Serv. Par. 49,107 (W. D. Penn. 1955); *Follansbee Steel Corp. v. United States*, Supp. Vol. CCH Fed. Tax Serv. Par. 48,108 (W. D. Penn. 1955); and *United Air Lines, Inc. v. United States*, Supp. Vol. CCH Fed. Tax Serv. Par. 49,088, 4 P-H 1955 Fed. Tax Serv. Par. 72,567 (N. D. Ill. 1955). Only the *United Air Lines* case has as yet been appealed, according to the tax services. That case was favorable to the taxpayer and will no doubt be affirmed in view of the appellate court's earlier decision in *Belden Mfg. Co. v. Jarecki, supra.* Of the other two cases, the *Follansbee* decision was for the taxpayer, the *Sharon* decision opposed.

II. THE DECISION BELOW IS CLEARLY CORRECT

In *United States v. Isham*, 17 Wall. 496, 504, 21 L. Ed. 728 (1873), this Court held, in referring to the stamp tax statute:

> "The words of the statute are to be taken in the sense in which they will be understood by that public in which they are to take effect."

The sense of the words used in the statute according to the understanding of that public in which they are to take effect has been conclusively established by the evidence received in this case and previously discussed. That evidence disclosed that the significant feature of a debenture is ready marketability as contrasted to the promissory notes here sought to be taxed. The terms, appearance and method of sale of debentures are all designed to achieve this result and even the Internal Revenue Service would not have contended that the present notes were taxable debentures prior to the decision in *General Motors Acceptance Corp. v. Higgins*, 161 F.2d 593 (2d Cir. 1947), cert. denied, 332 U. S. 810, 92 L. Ed. 387, 68 S. Ct. 111 (1947).

In the *General Motors* case, relied on by Petitioner and the case which persuaded the Bureau of Internal Revenue to reverse its prior administration construction of the statute, it appears from the opinion of the lower court, 60 F. Supp. 979, that the taxpayer sold 84 notes, varying in denomination from $100,000 to $1,000,000, 13 of said notes payable to the order of designated persons, 71 payable to bearer. All were negotiable. In assessing a stamp tax, the Commissioner relied primarily on the

appearance of the notes and regarded them as being issued in *registered form*. The case was tried on stipulated facts, and no testimony was offered or received as to the proper classification of the notes, 60 F. Supp. at 981. The appellate court held that the instruments in question were debentures, reversing the trial court's judgment in favor of the taxpayer.

The instruments in the *General Motors* case are distinguishable on the facts for the following reasons: (1) *Appearance*. The *General Motors* notes were tinted, engraved, bore serial numbers and the corporate seal, and otherwise, so far as appearance was concerned, bore every evidence of the ordinary corporate bond, debenture or other corporate security. These factors do not exist with respect to the Leslie Salt Co. notes. (2) *Terms*. The notes were negotiable as is customary with bonds or debentures, and were not in the nature of a simple contract to borrow and lend money as is true in the instant case. (3) *Mode of Sale*. Unfortunately, the facts are incomplete in this respect as reported in the two opinions. These omissions, however, are cured by reference to the case of *Belden Mfg. Co. v. Jarecki*, 192 F. 2d 213 (7th Cir. 1951), which discusses the record in *General Motors* which had been received in evidence. It appears that the sequence of events was first to print and engrave the notes, and second to offer the same for sale to the highest bidder in the investment public. The above sequence is that typically employed in the marketing of bonds, debentures or other corporate securities.

By contrast, the loans in the instant case were negotiated from beginning to end with only the two lending institutions which ultimately made the loans; terms were discussed before being reduced to writing, and the loan contracts, as ultimately executed, were the result of *prior* negotiations, not instruments which the borrower first executed, then sold to the highest bidder from the investing public.

In assessing the correctness of the *General Motors* case, it appears to the undersigned that the result is not wholly in error, since many features of the transaction were similar to debenture financing. Our objection goes to certain unfortunate statements contained in the opinion, which statements have since been repudiated by the same court in *Niles-Bement-Pond Co. v. Fitzpatrick*, supra. Our first objection to the language of the *General Motors* case goes to the attempt by the court (161 F. 2d at 596) to draw a distinction between what it calls "ordinary promissory notes" and notes which fall "into the category of debentures as that term is used in the statute in its setting with bonds, and certificates of indebtedness, to designate a type of corporate securities which does not include ordinary promissory notes." There is, of course, no statutory justification for drawing such a distinction, and the court was consequently unable to point to any language of the present or prior statutes to support its conclusion. The court also stated that the method of sale to a few investors who indicated their then intention not to resell was a key factor in throwing

the notes in question into the same general category as debentures and other corporate securities rather than in the category of ordinary promissory notes.

It is probable that the court fell into this latter error due to the fact that the taxpayer failed to offer any testimony as to how the instruments in question should be classified. With only the instruments before it the appellate court failed to realize that bonds, for example, are commonly widely sold, are constantly resold, and that it is unheard of in business and financial circles for a corporation to issue bonds or other corporate securities which it proposes to sell to one or two investors conditioned on the assurance by said investors that they do not plan to resell. As brought out by the record in the instant case, debentures are the same as bonds in this respect.[2] The very point which distinguishes a debenture bond or other corporate security from a promissory note is that they are continuously traded in after issuance and sold to a wider public; the facts the court relied on in stating that the notes were debentures are the precise facts which weakened such a holding.

In *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F. 2d 305 (2d Cir. 1954), the Court of Appeals distinguished its earlier opinion in the *General Motors* case, repudiated its earlier view that the only promissory notes exempt from tax were those "used customarily in day to day com-

[2]Though an issue of bonds or debentures might be sold to a single buyer if that buyer in turn planned to resell (R. 72).

mercial transactions of a short time credit character" and, by placing the emphasis on marketability as the typical characteristic of a debenture, also repudiated the earlier view that restrictions on transfer pushed an instrument into the classification of debentures rather than the converse.

It is submitted that in the instances where a court has ruled adversely to a taxpayer on facts similar to those at bar, the courts concerned have done so only by ignoring the language of the statute and speculating about the motive or state of mind of the borrower or lender or otherwise adding tests which do not appear in the plain language of the act which must control the result here. If Congress had wished to single out insurance company loans for taxation, nothing could have been easier than to say so. If loans of substantial amount and duration should be taxed and the small loan left free of tax, certainly Congress would have had no difficulty in saying as much. It is urged that the court below was clearly correct in commenting (R. 141):

> "We cannot but feel that in the considerable number of instances where courts have upheld exactions of the tax in situations analogous to the present they have invaded a field belonging exclusively to Congress."

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be denied.

DATED, San Francisco, California,
May 25, 1955.

Respectfully submitted,

WALTER C. FOX, JR.,
Attorney for Respondent.

BRUCE M. CASEY, JR.,
Of Counsel.

8

In the Supreme Court

OF THE

United States

October Term, 1955

No. 74

United States of America,

Petitioner,

v.

Leslie Salt Co.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF FOR LESLIE SALT CO.

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Attorney for Respondent.

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Of Counsel.

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In the Supreme Court
OF THE
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October Term, 1955

No. 74

United States of America, *Petitioner,* v. Leslie Salt Co.	

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

BRIEF FOR LESLIE SALT CO.

OPINIONS BELOW

The District Court's opinion is reported at 110 F. Supp. 680. The opinion of the Court of Appeals is reported at 218 F. 2d 91.

JURISDICTION

Jurisdiction is as set forth in the petitioner's brief.

QUESTION PRESENTED

Whether two instruments issued by a borrower to two insurance companies are what they purport to be and as the District Court and Court of Appeals found—promissory notes and not subject to tax—or are said instruments "debentures" or "certificates of indebtedness" and thus subject to tax within the meaning of Section 1801 of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

The statute and the present regulations are set forth in the petitioner's brief at pages 2-4.

Additional regulations or administrative material involved are Treasury Decision 2713, 20 Treas. Dec. Int. Rev. 358 (1918), Articles 8, 10, 14, 48, 58, Regulations No. 55, 22 Treas. Dec. Int. Rev. 502 (1920), and L.O. 909, Sales Tax Rulings, December 1920, S.T.-1-20, reproduced as Appendix A, B and C, respectively, to this brief.

STATEMENT

Petitioner's statement consists of a summary of the terms of one of the two notes which were taxed, and the accompanying certificate and loan agreement (Pl. Ex. 1, R. 44, 87; Pl. Ex. 2, R. 44, 90; Pl. Ex. 3, R. 45, 93, respectively). This summary is correct so far as it goes. However, entirely omitted from the petitioner's statement is any discussion of the testimony of the witnesses called, this testimony describing in detail the differences between

"debentures," which are subject to tax, and "promissory notes," such as the Leslie Salt Co. notes, which are not properly subject to tax.

On examination of the whole record, it is apparent that promissory notes on the one hand and debentures on the other have some similarities but that they also have significant differences. The key to the differences lies in the conflicting purpose each instrument is designed to serve. A debenture is designed for public offering and for easy resale if the purchaser so desires. Its terms, appearance and methods of sale are designed to accomplish this result. A non-negotiable promissory note (such as the two involved in the instant case) by its very nature cannot be offered for sale to the general public, nor can such a note be readily resold. Of course it is conceivable that instruments entitled "debentures" could be offered to only one lender and that said instruments could contain all terms customarily appearing in debentures. However, this procedure would be pointless unless the buyer, in turn, contemplated resale to the investing public and wanted to avoid the necessity of retiring an old instrument and the substitution of debentures before making a public offering (R. 72).

The difference in *purpose* between a debenture and promissory note should be kept in mind in evaluating the evidence we now discuss.

First, the method of sale. Leslie Salt Co. (hereafter referred to as Leslie) needed more money and had one of its directors approach the two insurance companies which made the loan (R. 49). No other prospective lenders were approached, and all negotiations were carried on directly

between the two insurance companies and the borrower without the services of an investment banker or other intermediary (R. 49). The two lenders took the initiative in drafting the terms of the loans, the terms were discussed, and the loans were closed in San Francisco (R. 50). By contrast, debentures are prepared to be sold as other corporate securities are sold in that they are designed to be offered to the ultimate buyers through the channels of investment bankers who employ their own distribution facilities (R. 62). The investment bankers act as middlemen in that they use their capital to purchase the issue and then resell to the public (R. 62, 63). The terms involved with respect to debentures are negotiated between the borrower and buying investment banker, or, in the case of competitive bidding, they are fixed solely by the borrower. But so far as the *ultimate* lender is concerned, terms are already fixed and his sole choice is limited to buy or not to buy. The two insurance companies making the Leslie loans were not presented with such a take-it-or-leave-it proposition; here the *lenders* took the initiative in presenting terms—the exact converse of the situation present when buying a debenture.

Although the services of an investment banker may be employed in the private placement of a promissory note, its role is that of a negotiating agent and neither its capital nor its distribution facilities are employed (R. 63). The notes may be placed without the aid of an investment banker at all, which was the case with Leslie (R. 63).

Other characteristics of a debenture sale as contrasted to the sale of a promissory note are (a) a sale of debentures is customarily advertised by an accompanying circu-

lar or prospectus, (b) a prospectus is filed with the Securities and Exchange Commission if the sale is of any size, (c) it is customary to attempt to obtain clearance with various state blue sky law commissions, (d) the underwriters request an opinion of counsel as to the legality of investment by various financial institutions (R. 70-71).

After original sale, debentures are constantly bought and sold and otherwise traded in after original issuance, and public quotations are made as to the going price (R. 69-70). There is no such after-market for notes such as the present ones (R. 70), and the Court will see that the lenders are acquiring the present notes for their own account and not for resale (Pl. Ex. 3, R. 45, 100).

With respect to terms and appearance, a debenture is accompanied by an indenture containing various protective provisions to protect the purchaser, and provision is made for an independent trustee to enforce the rights of the buyers as contained in the indenture (R. 61). The Leslie Salt Co. notes are accompanied by loan agreements which on their face are likewise designed to protect the lenders (Pl. Ex. 3, R. 45, 93). However, no trustee is created. The purpose of a trustee in connection with a debenture issue is that debenture issues are designed to be widely held and traded in, and individual debenture holders are in no position to effectively protect their rights (R. 62). When two informed lenders alone are involved, as is true with the Leslie Salt Co. loans, no trustee is needed. Protective features are usually more severe with respect to notes than for debentures (R. 61). Debenture certificates are prepared in a form to be negotiable and

have the word "debenture" printed on them, or engraved, together with restrictive covenants (R. 72). None of these features appear on the Leslie Salt Co. notes.

As to amount, debentures are usually offered in units of $1,000, or multiples thereof (R. 62). It is self-evident that the relatively small denomination of debentures is again designed to facilitate a wide distribution and easy resale, whereas notes such as the Leslie Salt Co. notes, in the amount of $1,000,000 and $3,000,000, respectively, are too high in price for such purpose.

The District Court made a finding of fact that the two promissory notes were what they purported to be and did not have the characteristics that would make them "debentures" *as said term is commonly defined* (R. 31). Accordingly, it entered judgment for respondent (R. 34-35). The judgment was affirmed by the United States Court of Appeals for the Ninth Circuit on December 16, 1954 (R. 142).

SUMMARY OF ARGUMENT

In February of 1949, the respondent issued two promissory notes in the amount of one and three million dollars, respectively, to two insurance companies, the notes being accompanied by loan agreements. A stamp tax was paid on the notes and this successful suit for refund followed.

The tax was imposed under the purported authority of the Internal Revenue Code of 1939 which assesses a tax of eleven cents a hundred dollars on "bonds, debentures, or certificates of indebtedness issued by any corporation,

and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities." (Italics added).

The words in italics were added by the Revenue Act of 1918. For approximately thirty years, and as conceded in M.T. 32, Cum. Bull. 1948-2, p. 160, petitioner would not have sought to tax notes such as the Leslie notes unless they could be placed within the framework of the 1918 addition, which admittedly does not apply to the Leslie notes.

Petitioner reversed its prior administrative construction about a year and a half before the Leslie notes were executed and contended that similar notes were "debentures," thus provoking the rash of litigation which ultimately prompted this Court to grant certiorari.

Petitioner also now makes the new and subsidiary contention that the Leslie notes are "certificates of indebtedness."

The validity of this changed administrative construction of the statute as applied to the Leslie notes is the issue in the case.

I.

The prior administrative construction was correct and the present interpretation incorrect. For debentures are marketable instruments issued in a series, accompanied by an indenture to which a trustee is a party. None of these features exist with respect to the Leslie promissory notes. Although this Court has never found it necessary to the decision to define the word debentures, its prior usage has been in accord with the above definition. The definition is

also supported by the detailed testimony of an expert witness (R. 51-74), this testimony being uncontradicted.

In opposition, petitioner relies on the definition of debentures as the word is used in England. This definition is irrelevant, as the usage is different in the United States.

Petitioner next relies on partial and incomplete American definitions referring to the similarities of debentures and promissory notes. Petitioner's American authorities are also of no help to this Court. For although promissory notes and debentures are similar in the sense that each contains a promise by the borrower to pay the lender, an instrument containing some of the essentials of a promissory note is not pushed into the classification of debentures unless it has the *additional* characteristics of a debenture such as an accompanying trust indenture.

II.

The trial court's finding of fact that the Leslie notes are not debentures is fortified by a provision in the loan agreement demonstrating in concrete form the differences between the Leslie notes and debentures. The provision in question permits the lenders to insist that the borrower create entirely new instruments to replace the present notes up to the then unpaid balance of the loan. These new instruments are in substance debentures because, unlike the notes now sought to be taxed, they are to be accompanied by a trust indenture and are to be in registered or coupon-bearing form. If and when such debentures are created a tax should be imposed. This provision does not, as contended by petitioner, aid in making the present notes taxable, because the statute taxes documents

already in existence, not hypothetical instruments which may or may not be created in the future.

III.

The legislative history confirms the fact that the Leslie notes are not debentures within the meaning of the statute.

Prior to the Revenue Act of 1918, the statute taxed "bonds, debentures and certificates of indebtedness." According to the administrative construction, whether called bonds, debentures, or notes, an instrument was taxable as a bond if issued in a series, accompanied by a trust indenture, and in registered form or with coupons attached.

This construction was approved by Congress, and in the Revenue Act of 1918 the words "and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities" were added to the statute. The committee reports and debate indicate that no change in substance had been made to the statute, so apparently the words were regarded as descriptive of the class of obligations already taxed, namely, bonds, debentures and certificates of indebtedness, or a "note" if containing the same features.

Promissory notes were taxed prior to 1924 but in a different paragraph of the statute and at a different rate. Regulations No. 55, adopted in 1920, distinguishes "notes" which are in reality bonds or debentures and should be taxed as such, and those to be taxed at the rate applicable to promissory notes. Instruments issued

in a series accompanied by a trust indenture and in registered form or with coupons attached were to be taxed as bonds whether called bonds, debentures or notes. On the other hand, notes which, like the Leslie notes, are not in registered form and do not have coupons were to be taxed at the rate applicable to promissory notes.

The tax on promissory notes was repealed in 1924 and that on bonds and debentures reenacted. In so acting, Congress was aware that the only notes the Treasury regarded as in substance bonds or debentures were those issued serially, accompanied by a trust indenture and in registered or coupon-bearing form, *none* of which features exist in the present case.

Notes not in registered form or with coupons attached continued to be regarded as non-taxable until 1947 when the Government persuaded the Second Circuit that notes in some respects similar to the Leslie notes should be taxed as debentures. That case provoked the present wave of litigation.

IV.

Petitioner also makes the last-minute contention that the present notes are "certificates of indebtedness." This contention was not made in denying the taxpayer's claim for refund or at trial and, although mentioned in passing on appeal, it was not pressed before the court below.

The administrative construction shows that in the past the Treasury has regarded the term "certificates of indebtedness" as being restricted to instruments having the character of "investment securities," which have always been regarded as corporate obligations which can

be bought and sold on the market—unlike the Leslie notes. None of the regulations, past or present, provide support for the present contention.

It is doubtful that the term "certificates of indebtedness" ever added much to the statute, since, as this Court has previously observed, the term is practically synonymous with bonds. In apparent recognition of this fact, Congress dropped certificates of indebtedness as a separate tax classification in the Internal Revenue Code of 1954, the committee reports indicating that no change of substance had been made.

V.

An affirmance here is supported by the great weight of authority below. Six factually similar cases have been won by the taxpayer before the appellate courts; only one appellate case which cannot be distinguished has been won by the petitioner, and that case relied on unnecessarily expansive language of a Second Circuit decision which has since been repudiated by the same court.

ARGUMENT.

1. THE EVIDENCE IN THIS CASE SUPPORTS THE PRIOR ADMINISTRATIVE CONSTRUCTION THAT THE LESLIE NOTES ARE NOT "DEBENTURES" AS THE WORD IS COMMONLY DEFINED AND ARE CONSEQUENTLY FREE FROM TAX.

To place this case in proper perspective, we should first note that in the past a stamp tax has been imposed on both "debentures" and "promissory notes" but always in different paragraphs of the statute and at different rates. The tax on notes was repealed in 1924. Conse-

quently, since petitioner cannot tax the Leslie notes as "promissory notes" it now contends they must be "debentures." However, in making this contention petitioner has reversed an administrative construction of some thirty years duration, as we point out in detail in Section Three of this brief. For although bonds, debentures and promissory notes are somewhat similar in that each contains a promise by the borrower to pay the lender, they have significant differences. Debentures have, in form, some of the qualities of promissory notes, as recognized by the authorities petitioner cites (Br. 20-25). However, although containing some of the essentials of a promissory note, such "notes" are pushed into the tax classification of bonds or debentures according to the past Treasury practice *only* if issued in a series, accompanied by an indenture to which a trustee is a party, and containing a provision for registration or with coupons attached. For approximately thirty years petitioner would not have regarded the Leslie notes as taxable as they lack *all* the foregoing features. The reversal in administrative construction came not because the definition of "debentures" has become expanded in financial usage or that of "promissory notes" contracted, not because Congress has amended the statute; it came solely because for a short period petitioner received some judicial support for an approach which concentrates on the similarity of promissory notes and debentures while wholly ignoring their differences.

The prior and contemporaneous administrative construction is of particular weight, since Congress on several occasions reenacted the statute taxing debentures and

certificates of indebtedness without significant change while that construction was still in effect. It was still in effect at the time of adoption of the Internal Revenue Code of 1939 under which petitioner attempts to apply the tax in this case. The *only* reenactment of the statute after petitioner changed its administrative construction occurred after the trial of this case with the passage of the Internal Revenue Code of 1954. Then, although Congress knew the administrative practice had been changed, it also knew that that change was being resisted, and for the most part successfully so, by taxpayers in the lower courts.

That the prior administrative construction was correct and the differences in the types of documents significant, rather than of no importance, is further confirmed by the uncontradicted evidence received in this case and by the authorities. In evaluating that evidence, we accept as axiomatic that the ordinary meaning of the term "debentures" was intended in the statute, and that this Court will adhere to its prior holding in *United States v. Isham*, 17 Wall. 496, 504, 21 L. Ed. 728 (1873), where, in referring to the stamp tax statute, the Court stated:

> "The words of the statute are to be taken in the sense in which they will be understood by that public in which they are to take effect."

The testimony below establishes the sense of the word "debentures" as the term is used and understood in the business and financial world which is the source of the tax. The usage, as brought out by the evidence, is confined to instruments which have qualities designed to permit their ready marketability. In contrast, the Leslie

notes are not marketable. Instead, their large size and lengthy duration[1]—the factors petitioner seizes upon in contending them to be debentures—are some of the principal factors which obviously prevent their marketability, which is the classic and essential feature of debentures.

Since the evidence has already been reviewed in some detail in our "Statement", we merely summarize at this point some of the principal features which set the Leslie notes in a class apart from debentures. Although two notes are involved, since they are identical except for amount and payee (R. 85) only one is included in the printed record. (Pl. Ex. 1, R. 44, 87). That note and the accompanying loan agreement (Pl. Ex. 3, R. 45, 93) and certificate (Pl. Ex. 2, R. 44, 90) differ from a debenture in important and essential respects, as follows:

1. *Terms.* There is no accompanying indenture, no provision for a trustee (R. 61), and the note is not prepared in a form to be negotiable (R. 33, 72).

2. *Mode of Sale.* The notes were the final result of prior negotiations directly between borrower and lender and no others (R. 49), and were not sold or designed to be sold to the investment public or the highest bidder (R. 62). The note was not designed for trading after original issuance and there is no after market for the note (R. 69). No investment banker or underwriter was involved, even as a negotiating agent (R. 49, 62-63, 70).

3. *Appearance.* Although of less importance, we do not find the word "debenture" printed or engraved on the note, nor any restrictive covenants

[1]One and three million dollars, respectively, each for fifteen years.

on its face (R. 72), the note being on plain white paper.

The business necessity for the provisions setting debentures apart from the Leslie notes is that a member of the buying public, typically buying a debenture through the channels of investment bankers and investment banker groups, does not negotiate at all as to terms—his sole choice is to buy or refuse to buy. And his choice is likely to be not to buy unless the debenture is in a form, as it invariably is, to permit easy resale, and the purchaser has the added protection of a trustee who will enforce the rights of all holders.

Although this Court has never found it necessary to the decision to define debentures, its usage of the term, so far as we can determine, has been confined to instruments having the same marketable characteristics deemed vital according to the evidence received in the record in this case and the prior administrative construction as mentioned above. Thus, in *First Nat. Bank v. Flershem*, 290 U.S. 504, 508, 511-512, 78 L. Ed. 465, 65 S. Ct. 292 (1934), Mr. Justice Brandeis, writing for the Court, uses the term "debentures" in referring to an issue which had been marketed by underwriters, was accompanied by an indenture to which a trustee was a party, and which had coupons attached.

The foregoing usage by this Court was nothing new. For in this country the attributes of "debentures" as the term is employed in *First Nat. Bank v. Flershem*, *supra*, existed since the early years of the century and prior, it should be noted, to the repeal in 1924 of the tax on promissory notes. Thus, in a paper entitled

"Preparation of Corporate Bonds, Mortgages, Collateral Trusts, and Debenture Indentures," by F. L. Stetson presented in 1916, which is contained in *Some Legal Phases of Corporate Financing, Reorganization and Regulation*[2], the author states:

> "In the United States, as already mentioned, the term 'debenture' is understood to mean *serial obligations* of a corporation not secured by a specific mortgage, pledge or assignment of property. Of course *a series* of debentures may be issued without the execution of any indenture relating thereto. *Prior to 1900 the few issues that had been made of such debentures were not accompanied by a trust agreement.* In such case the right and privileges given to bondholders were set forth at length in the obligation, thus making a somewhat lengthy instrument. *Since an issue of debentures under trust agreements by the Lake Shore R. R. Co. and by the New York Central, the custom of adopting such agreements has become general.* Originally in 1893 the General Electric Company made a large issue of debentures without an agreement, but at the time of the refunding in 1912 a trust agreement was executed" (p. 66). (Italics added.)

It thus appears that as early as 1916 debentures were regarded as instruments issued in a *series* accompanied by a trust indenture.[3]

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[2]This work contains a series of lectures given before the Association of the Bar of the City of New York in 1916. It was reprinted in 1930.

[3]Petitioner claims (Br. 30) that a single debenture can be issued to a single person, citing *Keeley v. Associated Gas & Electric Co.*, 155 Misc. 146, 278 N.Y.S. 962 (1935), a case which was apparently misread since it deals with *suit* on a single debenture, and there is no indication whatsoever that that debenture

The fact that debentures are designed to be bought and sold and otherwise traded has also been relied on by the lower courts in the present type of litigation in rejecting the Government's attempts to impose a tax on notes similar to the Leslie notes, e.g., *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305, 311 (2d Cir. 1954); *Atlanta Metallic Casket Co. v. Allen*, 99 F. Supp. 104, 106 (M.D. Ga. 1951), aff'd, 197 F.2d 460 (5th Cir. 1952) (also an insurance company case).

So far as the opinions in the reported cases disclose, petitioner has never been able to call a witness to present evidence concerning the characteristics of debentures which would support the all-encompassing definition petitioner has recently coined for purposes of this type of litigation. Therefore, to counter our position the petitioner employs two devices, neither of which has any foundation in the record or the language or history of the statute.

First, petitioner cites a series of English authorities. This is done despite the admonition in *United States v. Isham*, 17 Wall. 496, that the words of the statute are to be construed according to the understanding of the business and financial community in which it is to take effect. Even without this admonition, the common sense of the matter is that Congress intended the word "de-

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(in the amount of $2,000) was not one of a series. On the contrary, since the same utility was involved in other litigation with other debenture holders, e.g., *Fitzpatrick v. Associated Gas & Electric Co.*, 148 Misc. 538, 266 N.Y.S. 116 (1933) and *Emerson v. Associated Gas & Electric Co.*, 148 Misc. 636, 266 N.Y.S. 265 (1933), it seems a certainty that the *Keeley* debenture was part of a series. Petitioner's contention that debentures need not be issued in a series is thus without support in either the record or the American cases.

bentures" to be understood in accordance with the usage here in the United States, not that employed in the English Chancery Division. Petitioner's authorities are irrelevant.

Second, petitioner cites authorities which, in giving a partial definition of "debentures", comment on the similarities of debentures to promissory notes. Of course there are similarities, in the sense that every bond, debenture or promissory note contains a promise by the borrower to pay the lender. That does not mean that all three instruments somehow become debentures. For there are also significant differences as brought out without dispute by the evidence in this case.

The Leslie notes are not debentures by any ordinary and complete definition which has found acceptance as the word is used in this country. In urging that this Court accept the novel and all-embracing definition now fabricated for this case, the United States also impliedly urges a reversal of the Court's holding in *United States v. Isham*, 17 Wall. 496, 504, ignores its prior administrative construction of the statute, and exhorts this Court to invade a field occupied by Congress in extending the reach of the tax to instruments not included within the statute by any common understanding or meaning of its terms.

Further, in urging that this Court adopt the definition now coined, which includes virtually any promise to pay, petitioner's argument proves too much. For Congress always recognized that there were differences between promissory notes and debentures by taxing them in different paragraphs of the statute and at different rate. In

addition, Congress recognized, as we later point out, that certain instruments entitled "notes" were in substance bonds, debentures or certificates of indebtedness. To tax such documents it added a phrase to the statute in 1918 to tax such instruments at the rate applicable to bonds or debentures if the instrument was in registered or in coupon-bearing form. By rendering meaningless this 1918 addition in urging a tax on the Leslie notes despite the fact they are not in registered or coupon-bearing form, petitioner's argument violates all known canons of statutory construction, for acceptance of the argument makes nugatory the 1918 addition to the statute rather than giving effect to every word.

In the past, this Court has frequently stated that a tax statute will not be extended by implication and should be construed in favor of the taxpayer. We believe this position was correct. But whether or not it be adhered to now, whether the presumption be for or against the taxpayer, the Leslie notes do not somehow become debentures simply because it now seems wise or desirable to petitioner that they be taxed.

The court below demonstrated that it had a correct appreciation of its role and that of this Court when it stated, 218 F.2d at page 92 (R. 139):

> "It is altogether likely that had Congress foreseen the development of corporate financing by means of large long-term placement loans like these it would not have repealed outright the statutory tax it had imposed during the first World War on promissory notes, but would have modified the statute to conform with the development. Congress has since had abundant opportunity to legislate on the subject but

has not seen fit to do so. We can not but feel that in the considerable number of instances where courts have upheld exactions of the tax in situations analogous to the present they have invaded a field belonging exclusively to Congress."

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2. THE PRESENCE OF THE PROVISION PERMITTING SUBSTITUTION OF MARKETABLE OBLIGATIONS FOR THE EXISTING NOTES POINTS UP THE DIFFERENCES BETWEEN SAID NOTES AND DEBENTURES.

The loan agreement contains a provision (Pl. Ex. 3, Sections 4.2, 4.3, R. 45, 100-102) permitting the lender, at its election, to require the substitution of what are in substance debentures for the existing notes. By a curious process of inverted reasoning, petitioner contends (Br. 13, 29) that this provision shows that the original notes have the same character as the successor debentures. If this were so, why have the provision? Why go to the trouble of permitting substitution and the expense of preparation of a new series of instruments if nothing has been accomplished? The fact is that the original notes, in contrast to debentures, are in such form and denomination that they cannot readily be marketed. The necessity for the wholly different form of the new documents points up the distinction between the notes now sought to be taxed and the instruments Congress intended to tax.

Petitioner's logic is equally at fault when it contends that such a provision makes the original instrument "marketable" when the whole purpose of the provision is to substitute new obligations which *are* marketable for the old which are not.

We concede that if and when debentures are substituted for the old notes a tax should be imposed. That is not to say, however, that a tax should likewise be imposed on the old notes. For Congress was concerned with taxing instruments already in existence, not hypothetical instruments which may or may not come into existence in the future.

It should also be noted that petitioner has been unable to point to any evidence in the record or even any textbook authority, so heavily relied on elsewhere, that indicates that such a provision makes a note a debenture or otherwise taxable. Indeed, the testimony in the case indicates that a promissory note retains its character whether or not such a common provision is included (R. 69). It is submitted that the trial court's finding of fact (R. 30-31) that the two notes are not debentures is not weakened but clearly supported by the presence of the clauses in question which highlight in concrete form the essential differences between debentures and the Leslie notes.

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3. THE LEGISLATIVE HISTORY IN THE SETTING OF THE ADMINISTRATIVE CONSTRUCTION DEMONSTRATES THAT THE LESLIE NOTES ARE NOT TAXABLE.

Significantly absent from the Government's brief is any discussion of the administrative construction of the pertinent statute in its various forms. Yet, as conceded in M. T. 32, Cum. Bull. 1948-2, page 160, for a period of approximately thirty years the "long and uniform holding" of the Treasury was that notes such as those here involved are non-taxable. This administrative construc-

tion was spelled out in detail for years prior to the time of repeal of the tax on promissory notes, and in adopting the 1924 repealer of the promissory note tax while reenacting the tax on bonds and debentures Congress acted in the full knowledge that in accordance with that construction the tax would still apply only to marketable obligations of a character distinct from the notes now before this Court.

Once placed in the proper setting of the administrative construction, the legislative history establishes that the two courts below reached a correct result, as we shall demonstrate.

The first statute of significance for purposes of the present problem is the Revenue Act of 1917 (40 Stat. 300). Section 807 (p. 321) imposed a tax on "Bonds, debentures or certificates of indebtedness issued after the first day of December, 1917, by any person, corporation, partnership or association * * *." Promissory notes were taxed at a different rate under paragraph 6 of schedule A (p. 323).

In Treasury Decision 2713, May 14, 1918, 20 Treas. Dec. Int. Rev. 358 (1918)[4], a distinction was drawn between a bond and a promissory note for purposes of taxation, the Treasury Department concluding that some "notes" would be taxed at the rate applicable to bonds and debentures, the notes to be so taxed being described as follows:

> (2) Instruments containing the essential features of a promissory note, but issued by corporations in

[4]Reproduced in full as Appendix A to this brief.

> numbers under a trust indenture, either in registered form or with coupons attached, embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and sometimes for redemption before maturity, or similar provisions, are bonds within the meaning of the statute, whether called bonds, debentures, or notes. However, a short-term instrument, although issued by a corporation under a trust indenture, may be regarded as a note if every instrument of such issue both (a) is payable to bearer and incapable of registration and (b) lacks interest coupons and so requires presentation upon each payment of interest."

Although arbitrarily classifying the instruments referred to above as "bonds" for purposes of the tax, the definition applies equally to "debentures" which, in the same decision, the Treasury defines as "ordinarily" an unsecured bond.

The above administrative construction received express Congressional acceptance. In Schedule A, Title XI of the Revenue Act of 1918, 40 Stat. 1057, the debenture section was amended (p. 1135) to provide:

> "Bonds of Indebtedness: On all bonds, debentures, or certificates of indebtedness issued by any person, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, ..."

Section 1 of the Act (p. 1057) defined "person" to include corporations.

Judging from the contents of the committee reports[5] and the debate[6], Congress appears to have been of the opinion that no change in substance had been achieved by the added phrase, so that it seems likely that the 1918 addition was deemed merely descriptive of corporate obligations already taxed rather than adding new instruments to be taxed. This view was accepted by the Third Circuit which held, in *Bellefield Co. v. Heiner*, 25 F.2d 560, 562 (3d Cir. 1928):

> "Turning to the quoted provision of the Revenue Act for guidance, we find a more or less complete definition of taxable instruments under the heading of bonds, the critical parts being that an instrument

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[5]H.R. Reports Nos. 767 and 1037, and S. Report No. 617 on H.R. 12863 (65th Cong., 2d and 3d Sess.).

[6]See, for example, the following statements:

In the debate on H.R. 12863, Congressman Dixon stated (56 Cong. Rec., Part 10, p. 10,202):

> "The stamp taxes provided for in this bill simply re-enact the existing law, . . ."

Congressman Cannon said simply (56 Cong. Rec., Part 10, page 10,245:

> "The present stamp-tax law is re-enacted . . ."

To similar effect are the following:

(1) *56 Cong. Rec., Part 10, p. 10,469:*

> "Mr. Walsh. Mr. Chairman, is this [relating to Title XI—Stamp Taxes] the title of the bill in which there is but one change in the tax?
>
> "Mr. Kitchin. One change in the stamp tax on playing cards, . . ."

(2) *56 Cong. Rec. Appendix, Part 12, p. 641:*

[Congressman Hull] "The list of special taxes embraced in the bill is very similar to the system of special taxes found in the Civil War Revenue Act. The same may be said of the stamp taxes in the present law and which are re-enacted in the proposed bill."

(3) *56 Cong. Rec. Appendix, Part 12, p. 699:*

[Congressman Kitchin] "The next [title] is Title XI. That is the stamp tax. It is exactly as it is in the present law . . ."

taxable as a bond must be issued with interest coupons or in registered form."

In 1920, the Treasury further clarified the distinction between "notes" which in reality have the characteristics of bonds or debentures and promissory notes such as those now involved (Pl. Ex. No. 1, R. 44, 87) which were to be taxed at the lower rate applicable to promissory notes. Regulations No. 55, October 26, 1920, 22 Treas. Dec. Int. Rev. 502 (1920).[7]

The two significant provisions were as follows:

"ART. 8. Instruments issued by corporations in numbers, under a trust indenture, are bonds.—Instruments containing the essential features of a promissory note, but issued by corporations in series, secured by a trust indenture, either in registered form or with coupons attached, embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and in some instances for redemption before maturity, or similar provisions, are bonds within the meaning of the statute, whether called bonds, debentures, or notes."

* * * * *

"ART. 48. 'Promissory notes'.—(a) A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in money to such other person, or to order or to bearer, free from restrictions as to registration or transfer, and usually without coupons."

[7] All pertinent provisions are reproduced as Appendix B to this brief.

The Leslie Salt notes clearly come within the last-quoted definition and escape the former. Although the definition employs the word "person", the corporate note is also included since "person" is defined in the Revenue Act of 1918 (Section 1) to include corporations as well as individuals. Also, the Leslie notes are expressly made free from restrictions on transfer (Pl. Ex. No. 3, Section 4.1, R. 45, 100), and are not registered nor do they have attached coupons (R. 31).

It should be noted that once the Treasury issued a formal regulation it retreated from an earlier view, which it had adhered to for only two years, in T. D. 2713, *supra*, that a promissory note was "such as is common in everyday commercial use." No such restriction appears in Article 48. Further, the Treasury was clearly correct in placing a less restrictive construction on the term "promissory notes." For a promissory note does not become a bond, a debenture, or a certificate of indebtedness because in elaborate form anymore than a fifty-year, highly detailed lease somehow becomes a deed. As said in *Belden Mfg. Co. v. Jarecki*, 192 F.2d 211, 214 (7th Cir. 1951):

> "Neither are we impressed with the argument that because certain provisions contained in the application are the same as or similar to those ordinarily found in a debenture, they require that it be characterized as such. Even if such be the case, such provisions are equally compatible with the theory that the instrument in question was a note. Defendant lays much stress upon the fact that the loan was for a large amount and for a long period. Defendant states in his brief, "by the issuing of this instru-

ment, taxpayer obtained working capital of $1,000,000 for a substantial period of time, just as it might have done by the sale of its bonds, debentures or similar securities'. This may be a circumstance but, if so, it is of minor consequence. We do not think a note changes its character because it is for $1,000,000 rather than for a lesser amount, nor because it is payable over a period of five years rather than over a shorter time."

The foregoing definitions were promulgated anew in 1922. Regulations No. 55, June 12, 1922, 24 Treas. Dec. Int. Rev. 895 (1922).

Congress, of course, reenacted the tax on bonds and debentures but repealed the tax on promissory notes in 1924, and notes have not subsequently been taxed. Revenue Act of 1924, 43 Stat. 253, Schedule A, Title VIII.

With the prior administrative interpretation before us, we need not speculate or guess as to what Congress had in mind in adopting the 1924 repealer, for by that time the formally enacted regulations had for a period of some years duration made clear that the only instruments entitled "promissory notes" which were and would continue to be taxed as bonds or debentures were those issued in a series, accompanied by a trust indenture, and is registered as coupon-bearing form. On the other hand, the definition of the "promissory notes," upon which the tax was repealed, was quite broad. The Treasury had added no restrictions as to duration, amount, character of borrower or lender, or purpose of the loan; unless an instrument had the marketable characteristics of debentures previously discussed, Congress knew it re-

pealing the tax that under the Treasury practice no tax would be imposed. Indeed, this was exactly what happened for a period of in excess of twenty years and until the Government's unexpected success in *General Motors Acceptance Corp. v. Higgins*, 161 F.2d 539 (2d Cir. 1947), the case which produced the rash of litigation which prompted this Court to grant certiorari in the present action.

Under the circumstances, the petitioner's argument to the effect that the only note relieved of tax was the simple I.O.U. does not rise even to the dignity of a make-weight. The entire argument rests on a few scattered comments of various Congressmen in a highly political setting, *wholly* ignores the administrative history of the statute, and flies in the face of the concession made elsewhere that Congress was aware that corporations were paying the bulk of the promissory note tax as a result of large loans (Br. 38).

It required no clairvoyance by Congress to foresee that some corporations would borrow large sums for lengthy periods on promissory notes with detailed restrictions and still avoid tax. This result was inevitable under the then administrative construction of the statute. We concede that the aggregate amount of such borrowing has, as contended by petitioner (Br. 39), probably exceeded expectation. But this contention should be addressed to Congress in an effort to amend the statute. A tax-free note does not become a taxable debenture merely because the use of such notes is on the increase.

It should perhaps be added that we should not be understood as implying that the Leslie notes must neces-

sarily be "promissory notes" as defined by the Treasury in 1924 to avoid tax. We submit they are. But even were this Court to reject our contention, the Government is no better off unless it affirmatively establishes that the instruments in question are debentures. See, Judge (now Mr. Justice) Harlan's comments in this connection in *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305, 308 (1954).

And in determining whether the instant notes affirmatively appear to be debentures, this Court does not have before it a statute of broad and far-reaching significance intended to embrace virtually any type of transaction as contended by petitioner (Br. 29-30). Instead, as the pre-1924 administrative and legislative history makes clear the only instruments purporting to be promissory notes which Congress still intended to tax were those which had the same characteristics as bonds or debentures, namely, accompanied by a trust indenture and in registered form or with coupons attached. This was the purpose of the 1918 addition to the statute, which clarified the law, as recognized by the Treasury itself. Thus, in L. O. 909, Sales Tax Rulings, December 1920, S.T.-1-20[8], the Solicitor of Internal Revenue states:

> "The words 'all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities', were clearly added in recognition of the varied forms in which corporate securities are issued, and to defeat any attempt to avoid the tax by issuing instruments of the *general character of bonds, deben-*

[8]Reproduced in full as Appendix C to this brief.

tures, or certificates of indebtedness under a different name." (Italics added.)

But the *only* instruments bearing a name other than bonds, debentures, etc., which are taxed, according to the statute, are those of the same general character in that they bear coupons or are in registered form. Petitioner now seeks to go beyond the terms of the statute and tax notes such as the Leslie notes simply because they are for a large amount and a lengthy duration despite the fact that they do not bear coupons and are not in registered form. Petitioner's argument, of course, if accepted would render meaningless the words of the 1918 addition to the statute, and for this reason must be rejected. As stated in *Ex Parte Public Bank*, 278 U.S. 101, 104, 73 L. Ed. 202, 49 S. Ct. 43 (1928):

> "No rule of statutory construction has been more definitely stated or more often repeated than the cardinal rule that 'significance and effect shall, if possible, be accorded to every word. As early as in Bacon's Abridgment, sect. 2, it was said that "a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." ' "

On this point, the subsequent history of the statute is also illuminating.

In the Revenue Act of 1926, 44 Stat. 9, Schedule A, Title VIII, the word "corporation" was substituted for "person" in the first section (p. 101).

Shortly thereafter, a new regulation again defining terms was promulgated. Regulations 71, July 13, 1926, 28 Treas. Dec. Int. Rev. 313 (1926). Article 12 thereof

again defined documents purporting to be promissory notes which would be taxed as bonds or debentures, and no attempt was made to expand the scope of the prior definition in Regulations No. 55 despite the fact that the tax on promissory notes had then been repealed.

In 1939, the title of the first section was changed from "Bonds of Indebtedness" to "Corporate Securities" (Section 1801, Internal Revenue Code of 1939, 53 Stat. 195) so that Section 1801 read as follows:

> "Corporate Securities. On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, . . ."

The above version of the statute is the one under which petitioner seeks to impose the present tax. At the time of passage, it should be noted, under Regulations 71 the Government would still not have sought to impose a tax on the Leslie notes unless they were in registered form or had coupons attached, according to the concession in M. T. 32, Cum. Bull. 1948-2, p. 160.

In 1941, Regulations 71 was amended and took the form it has today. Nevertheless, the administrative construction of the statute and regulations for the succeeding six years left the Leslie notes free from tax.

The turning point came in 1947 with the Government's victory in *General Motors Acceptance Corp. v. Higgins*, 161 F.2d 593 (2d Cir. 1947), *cert. denied*, 332 U.S. 810, 92 L.Ed. 387, 68 S. Ct. 111 (1947).

Before the lower court, judging from the contents of the opinion, the Government took the position that the notes involved, representing large corporate borrowing and accompanied by elaborate protective provisions, were in registered form and consequently taxable. If this contention was sound, the notes were taxable under the prior administrative practice, but the argument was rejected. *General Motors Acceptance Corporation v. Higgins*, 60 F. Supp. 979, 984 (S.D.N.Y. 1945).

On appeal, and apparently for the first time, the Government jettisoned the prior administrative construction and contended the instruments were debentures. This contention was accepted by the Second Circuit in an opinion which discloses that the court completely misunderstood the nature of debentures and in language so expansive that the Bureau of Internal Revenue was encouraged to start its present campaign to tax promissory notes such as those now before this Court.

Since even the *GMAC* notes, much more characteristic of debenture financing than the Leslie notes, as we later point out, would not have been held taxable under the Bureau's practice prior to 1947, in recognition of the radical nature of its departure from the "long and uniform" practice it had adhered to before the Bureau did not apply the *General Motors* case retroactively. Its new position was published shortly after the case came down and is reported in M.T. 32, Cum. Bull. 1948-2, p. 160. We quote in full the significant portion of said ruling, as follows:

"*The Bureau has for a considerable period of time held that an instrument termed 'note', not in*

registered form and issued without interest coupons, is not subject to the stamp tax upon issuance or transfer. Because of this *long and uniform holding* of the Bureau and the consequent reliance of corporations on these rulings, it has been concluded that, under the authority contained in section 1(b) of the Internal Revenue Code, the decision in *General Motors Acceptance Corporation v. Higgins, supra,* will not be applied retroactively, except that any tax which has been paid on the issuance or transfer of instruments falling within the scope of the decision will not be refunded." (Italics added.)

At the outset of its campaign, as a result of the confusion engendered by the *General Motors* case the Bureau was able to persuade a District Court in Maryland to follow its views. *Commercial Credit Co. v. Hofferbert,* 93 F. Supp. 562 (D. Md. 1950). In so doing, however, the District Court followed the erroneous reasoning of the *General Motors* case, apparently without independent analysis. This decision was affirmed by the Fourth Circuit in a per curiam opinion, 188 F. 2d 574, again without independent analysis. Since this decision was reached, however, and on more mature consideration, the Courts of Appeal for six circuits, counting the decision below, have taken a second look at the Bureau's attempted rewriting of the statute and have refused to sustain its position, which is how the matter stands at present.

It was, it should be emphasized, only from the dubious vantage-point of in excess of twenty years hindsight that petitioner suddenly decided that the legislative history of the statute was such that promissory notes such as the Leslie notes were somehow debentures or certificates

of indebtedness. As conceded in M. T. 32, Cum. Bull. 1948-2, p. 160, the *contemporaneous*[9] construction of the statute in the setting of its history would have resulted in a Treasury decision that the instant notes are non-taxable. This interpretation existed both before and after the date of publication of Treasury Regulations 71 (1941 ed.), relied on by petitioner. We consequently submit that this Court should follow the earlier and correct administrative construction of the statute and should reject the Bureau's belated and short-lived attempt to rewrite the statute which controls the decision in the case at bar. See, *Jones v. Liberty Glass Co.*, 332 U.S. 524, 533-534, 92 L.Ed. 142, 68 S. Ct. 229 (1947).

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4. THE PETITIONER'S WHOLLY NEW ARGUMENT THAT THE LESLIE NOTES ARE "CERTIFICATES OF INDEBTEDNESS" IS LIKEWISE AT WAR WITH THE LEGISLATIVE AND ADMINISTRATIVE HISTORY.

Petitioner now states (Br. 32-34) that the Leslie notes are "certificates of indebtedness" despite the fact that the Commissioner made no such contention in denying the claim for refund (Pl. Ex. 7, R. 61, 137), nor was it made at trial (R. 57) or pressed before the Court of Appeals, as demonstrated by the failure of the opinion to mention the contention.

It is apparent that petitioner now deems it prudent to seek refuge in the comforting vagueness of the phrase "certificates of indebtedness" solely because so many

[9] Clearly the construction entitled to greatest if not controlling weight. *Norwegian Nitrogen Co. v. United States*, 288 U.S. 294, 315, 77 L.Ed. 796, 53 S.Ct. 350 (1933).

courts have expressly rejected its primary contention that notes such as the Leslie notes are "debentures."

However vague the term may be, however, it is not sufficiently broad to embrace the Leslie notes as the legislative and administrative history make clear.

In Treasury Decision 2713, May 14, 1918, 20 Treas. Dec. Int. Rev. 358 (1918), it is stated:

> "A 'certificate of indebtedness' is primarily any instrument acknowledging liability for the payment of money, not in the recognized form of a promissory note or bill of exchange."

This definition was considered too broad, and in 1920 an opinion of the Solicitor of Internal Revenue was published recommending that T. D. 2713 should be modified so that only instruments having the character of "investment securities" would be included in the phrase "certificates of indebtedness." L. O. 909, Sales Tax Bulletin, December 1920, S.T.-1-20, p. 84[10]. It is of interest that the Solicitor was aided by the citation of a decision of this Court, *Denver v. Home Savings Bank*, 236 U.S. 101, 105 (1914), stating that it is difficult to see any distinction between bonds and certificates of indebtedness as the two are known in the business world.

Following the foregoing opinion, Article 14 of Regulations 55, October 26, 1920, 22 Treas. Dec. Int. Rev. 502 (1920), defined certificates of indebtedness as follows:

> "The term 'certificates of indebtedness' includes only instruments having the general character of *investment securities* as distinguished from instru-

[10] This opinion is reproduced as Appendix C to this brief.

ments evidencing debts arising in ordinary transactions between individuals." (Italics added.)

As pointed out in *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305, 311 (2d Cir. 1954), the classic feature of "investment securities" is ready marketability, which is emphatically not the case with the Leslie notes. This usage is of long duration, as made clear from the opinion in *Robotham v. Prudential Ins. Co.*, 64 N.J. Eq. 673, 686, 53 Atl. 842, 847 (1903), where the court distinguishes a loan by an insurance company to a corporation directly on the corporation's promissory note, as was done in the Leslie case and in 1903 was illegal in New Jersey, and purchasing investment securities, the court saying in the latter connection:

> "The safe and natural construction of this law, in my opinion, confines the investment of insurance funds, so far as they may be invested in the stock and evidences of indebtedness of private corporations, to such stock or obligations *as may be bought on the market*, and are commonly referred to as 'investment securities'." (Italics added.)

This usage of the term is further confirmed by the language of the McFadden-Pepper Act, 44 Stat. 1224, dealing with permitted investments for national banks, the statute saying in this connection (p. 1227):

> "[T]he business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse *marketable obligations* evidencing indebtedness of any person, co-partnership, association, or corporation, in the form of bonds, notes and/or debentures, *commonly known as investment securities*, under such further definition of the

term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency * * *." (Italics added.)

The definition of certificates of indebtedness as "investment securities" contained in the regulations remained without change until 1941 when the regulations (Regulations 71, 1941 ed.) merely provided that instruments having the essential nature of bonds, debentures, or certificates of indebtedness would be taxable as such. This change hardly indicates an intention to abandon the requirement that certificates of indebtedness must qualify as investment securities since this is their "essential nature", and this apparently was the view of the Treasury which conceded in M. T. 32, Cum. Bull. 1948-2, p. 160 that notes such as the Leslie notes were not taxable prior to the *General Motors* decision. They would, of course, have been taxable prior to that case if regarded as "certificates of indebtedness" under Regulations 71 (1941 ed.), which remains unchanged to this day.

Indeed, it seems doubtful that the term "certificates of indebtedness" ever added anything to the statute, except to tax instruments which were in substance bonds although labelled "certificates of indebtedness" by the issuer, being, as this Court points out in *Denver v. Home Savings Bank, supra,* practically synonymous with bonds. This view appears to be shared by Congress since certificates of indebtedness have been dropped as a separate classification, the sole remaining use of the term being a generic one to embrace bonds, debentures and coupon-bearing or registered notes. In this connection, Section 4381 of the Internal Revenue Code of 1954, 68A Stat., Ch. 34, now provides:

"SEC. 4381. DEFINITIONS.

(a) *Certificates of Indebtedness.*—For purposes of the taxes imposed by sections 4311 and 4331, the term 'certificates of indebtedness' means bonds and debentures; and also includes all instruments, however termed, issued by a corporation with interest coupons or in registered form, known generally as corporate securities."

In dropping certificates of indebtedness as a separate classification, it is also of interest that from the contents of the committee reports Congress assumed it had made no change of substance[11].

So far as the lower court decisions are concerned, although petitioner is unable to point to a single appellate decision that holds that notes in any way similar to the Leslie notes are "certificates of indebtedness" it purports to take some comfort (Br. 34) in the fact that, at least, only one Court of Appeals has found it necessary to expressly rule to the contrary. *General Motors Acceptance Corporation v. Higgins*, 161 F.2d 593, 595 (2d Cir. 1947). All this proves is that apparently petitioner lacked the temerity to make this patently erroneous contention before any of the six United States Courts of Appeal which have rejected its views that notes similar to the Leslie notes are debentures. Certainly this was the origin of the failure to refer to "certificates of indebtedness" in either of the opinions filed in the present case. Nevertheless, each of said six decisions implicitly ruled that instruments such as the Leslie notes are not "certificates

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[11] S. Rept. 1622, 83d Cong., 2d Sess. (1954), at p. 482; H. Rept. 1337, 83d Cong., 2d Sess. (1954), at p. A324.

of indebtedness" in that each court held them non-taxable under Section 1801 of the Internal Revenue Code of 1939 which embraces the term.

Even assuming, which to us seems erroneous, that at this late date petitioner should be allowed to make this contention, petitioner's last-minute argument cannot be squared with the history and words of the statute, the language of the regulations, or the weight of authority.

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5. AN AFFIRMANCE HERE IS SUPPORTED BY THE GREAT WEIGHT OF AUTHORITY ON THE POINT BELOW.

The decisions below fall into two categories which, for convenience, we will refer to as the "*GMAC* group" and the "*Leslie* group."

The line of demarcation comes best into focus by examining two decisions by the same court, *General Motors Acceptance Corp. v. Higgins*, 161 F.2d 593 (2d Cir. 1947), *cert. denied*, 332 U.S. 810, 92 L. Ed. 387, 68 S. Ct. 111 (1947), where the decision was for the Government, and *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305 (2d Cir. 1954), where the decision was for the taxpayer, the court rejecting some of its earlier language in the *General Motors* case.

Although we repeat, to some extent, the discussion of the *General Motors* case contained in our brief in opposition to the petition for certiorari, for the convenience of the Court we note again at this point that in that case, heavily relied on here, and the decision which persuaded the Bureau of Internal Revenue to reverse its prior administrative construction of the statute, it appears from

the opinion of the lower court, 60 F. Supp. 979, that the taxpayer sold eighty-four notes, varying in denomination from $100,000 to $1,000,000, thirteen of said notes payable to the order of designated persons, seventy-one payable to bearer. All were negotiable. In assessing a stamp tax, the Commissioner relied primarily on the *appearance* of the notes and regarded them as being issued in *registered form*. The case was tried on stipulated facts, and no testimony was offered or received as to the proper classification of the notes, 60 F. Supp. at 981. The appellate court held that the instruments in question were debentures, reversing the trial court's judgment in favor of the taxpayer.

The instruments in the *General Motors* case are distinguishable on the facts for the following reasons: (1) *Appearance*. The *General Motors* notes were tinted, engraved, bore serial numbers and the corporate seal, and otherwise, so far as appearance was concerned, bore every evidence of the ordinary corporate bond, debenture or other corporate security. These factors do not exist with respect to the Leslie notes. (2) *Terms*. The notes were negotiable as is customary with bonds or debentures, and were not in the nature of a simple contract to borrow and lend money as is true in the instant case. (3) *Mode of Sale*. Unfortunately, the facts are incomplete in this respect as reported in the two opinions. These omissions, however, are cured by reference to the case of *Belden Mfg. Co. v. Jarecki*, 192 F.2d 211 (7th Cir. 1951), which discusses the record in *General Motors* which had been received in evidence. It appears that the sequence of events was first to print and engrave the notes, and sec-

and to offer the same for sale to the highest bidder in the investment public. The above sequence is that typically employed in the marketing of bonds, debentures or other corporate securities. By contrast, the loans in the instant case were negotiated from beginning to end with only the two lending institutions which ultimately made the loans; terms were discussed before being reduced to writing, and the loan contracts, as ultimately executed, were the result of *prior* negotiations, not instruments which the borrower first executed, then sold to the highest bidder from the investing public.

In assessing the correctness of the *General Motors* case, it appears to the undersigned that the result is not wholly in error, since many features of the transaction were similar to debenture financing. Our objection goes to certain unfortunate statements contained in the opinion, which statements have since been repudiated by the same court in *Niles-Bement-Pond Co. v. Fitzpatrick, supra.* Our first objection to the language of the *General Motors* case goes to the attempt by the court (131 F.2d at 596) to draw a distinction between what it calls "ordinary commercial promissory notes", apparently of a short time credit character, and notes which fall "into the category of debentures, as that term is used in the statute in its setting with bonds, and certificates of indebtedness, to designate a type of corporate securities which does not include ordinary promissory notes." There is, of course, no statutory justification for drawing such a distinction, and the court was consequently unable to point to any language of the present or prior statutes to support its conclusion. Further, the court's position was at variance

with the administrative construction of the statute in the light of its history in that previously no notes were taxed, whatever the amount and duration, unless bearing coupons or, in registered form, a fact which apparently was not called to the court's attention.

The court also stated that the method of sale to a few investors who indicated their then intention not to resell was a key factor in throwing the notes in question into the same general category as debentures and other corporate securities rather than in the category of ordinary promissory notes. It seems likely that the court fell into this latter error due to the fact that the taxpayer failed to offer any testimony as to how the instruments in question should be classified. With only the instruments before it, the appellate court failed to realize that bonds and debentures are prepared in a form to permit constant selling and reselling if so desired and that, if anything, an intention not to transfer is at variance with existence of the taxable, marketable instruments which are designed to permit transfer.

The court in the *General Motors* case went on to discuss whether the absence of registration or attached coupons had any significance. It noted that Congress added a provision to the statute in 1918 (40 Stat. 1057) taxing "instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities." The court concluded that it was "obvious" that this addition was to catch additional instruments not formerly taxable rather than to limit the taxation of debentures to a debenture which also bore interest coupons or was issued in registered form.

This reasoning is relatively unobjectionable so far as it goes, but the court fell into error by reason of its failure to further pursue its analysis. What "instruments however termed" were meant by the statutory addition? The answer that immediately comes to mind is a promissory note which does not purport to be a debenture, a bond, or a certificate of indebtedness, but which *is* issued with interest coupons or in registered form. As discussed in greater detail earlier in this brief, for a period in excess of twenty years this construction of the term "all instruments" was that given by the Treasury—the only *notes* taxed were those issued with coupons or in registered form; all others were not taxed. See the ruling contained in M. T. 32, Cum. Bull. 1948-2, p. 160, reversing the prior interpretation. In thus expanding the classification of taxable notes beyond those encompassed in the phrase "all instruments," the Second Circuit thus rendered nugatory the entire statutory provision it purported to construe.

It is not necessary for an affirmance here that this Court reject the holding in the *General Motors* case that the 1918 amendment to the statute did not mean that a "debenture" had to be in registered form or with attached coupons before it was taxable, although, as we have earlier pointed out, the legislative and administrative history indicates that this holding is wrong. We submit, however, that at the very least the implication of the amendment, as the Bureau of Internal Revenue previously held, is that however complicated and elaborate be the protective features accompanying a promissory note, it is still not subject to tax unless it also is in

registered form or with attached coupons. The Leslie notes are not in registered form nor do they have attached coupons (R. 31), and are consequently not taxable.

When the same court got a second chance to pass on the same question in *Niles-Bement-Pond Co. v. Fitzpatrick*, 213 F.2d 305 (2d Cir. 1954), the court, in an opinion by Judge (now Mr. Justice) Harlan, distinguished its earlier opinion in the *General Motors* case, repudiated its earlier view that the only promissory notes exempt from tax were those "used customarily in day to day commercial transactions of a short time credit character" and, by placing the emphasis on marketability as the typical characteristic of a debenture, also implicitly repudiated its earlier view that an intention not to transfer pushed an instrument into the classification of debentures rather than the converse.

The *Niles* opinion also distinguished the *GMAC* notes on the grounds of their different means of sale, the fact there was no negotiation between borrower and lender as to the *terms* of the note but merely as to their *price*. The same distinction also exists on the present facts, as does a third relied on by the Second Circuit—the fact that none of the notes before it in contrast to certain of the *GMAC* notes were made payable to bearer.

As to the other appellate decisions, none have been in favor of the Government except *Commercial Credit Co. v. Hofferbert*, 188 F.2d 574 (4th Cir. 1951), a per curiam affirmance of a trial court's opinion in 93 F. Supp. 562 (D.C. Md. 1950). Since the case blindly follows the GMAC

decision without independent analysis, it is entitled to no weight here.

By contrast, in addition to the *Niles* case we also find the following appellate decisions in the *Leslie* group: *Belden Mfg. Co. v. Jarecki*, 192 F.2d 211 (7th Cir. 1951); *Allen v. Atlanta Metallic Casket Co.*, 197 F.2d 460 (5th Cir. 1952); *United States v. Ely & Walker Dry Goods Co.*, 201 F.2d 584 (8th Cir. 1953); and *Curtis Publishing Co. v. Smith*, 220 F.2d 748 (3d Cir. 1955), petition for writ of certiorari filed July 22, 1955, No. 254, this Term.

Although contending that all of the above cases are wrong, the United States also claims that they may be distinguished. The fact is, however, that in each instance large scale and long duration loans were involved accompanied by elaborate protective agreements—in short, the very factors relied on in the attempt to justify a tax in the present case. It is true that in some instances one or more of the courts involved mention minor factual distinctions between the cases in question and the facts of the Leslie case. It is submitted, however, that none of these distinctions survive analysis with respect to the Government's claim that the Leslie case is weaker for the taxpayer than the other cases. The mention of such distinctions, where it occurs, may be explained, we submit, solely on two grounds, viz., industriousness of counsel in other cases in urging every conceivable factual distinction whether or not of true significance, and the understandable reluctance of the judiciary to state in so many words that the language of the *General Motors* case and the result of the *Commercial Credit* case are wrong.

More specifically, petitioner contends that the *Niles* decision holds that the *GMAC* decision involved marketable notes in that there was a provision providing for notes of a smaller denomination to be substituted for the existing obligations. How persuasive this distinction may have been to the Second Circuit in reaching its result in the *Niles* case we do not purport to know. We do know that the court was careful to state in the *Niles* case that a *combination* of factors, which does not exist in the Leslie case, was responsible for its ruling in the *General Motors* decision rather than any single factor. Further, in the instant case, as we earlier pointed out, the provision for substitution of debentures for the existing notes merely points up the fact that two informed lenders regarded the instant notes as so clearly non-marketable—regardless of Leslie's standing in the financial community—that they recognized that if marketability were to be achieved under any circumstances entirely new instruments would have to be executed. Such new instruments would be taxable. That does not make the old notes taxable unless this Court is prepared to hold, as petitioner apparently urges, that a tax should be imposed on the basis of hypothetical instruments which may or may not be issued in the future rather than those that were actually issued.

Petitioner further points out that the lender in the *Niles* case was a bank, insurance companies in the present case. However, the terms of loans, in all material respects similar to those now involved, are the same whether the lender be an insurance company or a bank according to the undisputed evidence in this case (R. 62-

64). Sometimes, in fact, a bank and an insurance company participate in the same transaction, the bank holding the earlier maturities and the insurance company the later (R. 64). That this is a common practice is confirmed by the article entitled "Term Lending to Business by Commercial Banks in 1946" by Duncan McC. Holthaus then on the staff of the Board of Governors of the Federal Reserve System, reported in the *Federal Reserve Bulletin* of May, 1947 (p. 500).

Petitioner also contends that the *Niles* loan was not for investment and the Leslie loans were. It is true that Mr. Justice Harlan referred to purchase of an "investment" and "investment securities" in writing the *Niles* decision. As we read the decision, however, the quoted words must be understood in the banking context of the case. For by statute the "investment" department of a national bank is restricted to the purchase of "investment securities," which must be marketable. Banking Act of 1933, 48 Stat. 162, Section 25, 12 U.S.C. §24 (1946). The Leslie notes do not qualify as such instruments. Thus, although in a sub-heading of the accompanying agreement (Pl. Ex. 3, Section 4, R. 45, 100) we find the phrase "Purchase for Investment," the words are used in a sense directly contrary to the banking sense in that it is apparent from the words immediately following that all the parties meant is that there was no present intention to resell. Indeed, great difficulty would lie due to the lack of marketability in reselling the Leslie notes whether or not there was included such a provision.

In the interests of brevity, we will not discuss the numerous district court cases in the present field, all of

which are cited in the petitioner's brief. However, in closing this portion of our discussion, we emphasize that the result of all appellate decisions below which are in any way persuasive is in accord with an affirmance here. The only factually similar case which was for the Government relied on unnecessarily expansive language in the *General Motors* case which is demonstrably erroneous, as recognized by the same court in a subsequent decision.

CONCLUSION.

For the reasons stated, the decision below should be affirmed.

Dated, San Francisco, California,
October 17, 1955.

Respectfully submitted,

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BRUCE M. CASEY, JR.,
Of Counsel.

(Appendices A, B and C Follow.)

Appendix A

(T. D. 2713.)

STAMP TAXES.

Classification of bonds of indebtedness and promissory notes for the purpose of the stamp tax.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.

To collectors of internal revenue and others concerned:

By Schedule A of Title VIII of the act of October 3, 1917, stamp taxes are imposed as follows:

1. Bonds of indebtedness: Bonds, debentures, or certificates of indebtedness issued on and after the first day of December, nineteen hundred and seventeen, by any person, corporation, partnership, or association, on each $100 of face value or fraction thereof, 5 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue: *Provided further*, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured.

* * * * *

6. Drafts or checks payable otherwise than at sight or on demand, promissory notes, except bank notes issued for circulation, and for each renewal of the same, for a sum not exceeding $100, 2 cents; and for each additional $100 or fractional part thereof, 2 cents.

Although in a broad sense many notes are bonds and many bonds are notes, obviously Congress did not intend

to tax the same instrument under two heads. The following propositions are believed to express the legislative intent:

(1) An instrument under seal conditioned in a penal amount for the payment of a sum of money, such as often accompanies mortgages, is a bond within the meaning of the statute.

(2) An instrument not under seal containing a simple promise to pay a sum of money at a specified time, such as is common in every-day commercial use, is a promissory note within the meaning of the statute.

(3) Instruments containing the essential features of a promissory note, but issued by corporations in numbers under a trust indenture, either in registered form or with coupons attached, embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and sometimes for redemption before maturity, or similar provisions, are bonds within the meaning of the statute, whether called bonds, debentures, or notes. However, a short-term instrument, although issued by a corporation under a trust indenture, may be regarded as a note if every instrument of such issue both (a) is payable to bearer and incapable of registration and (b) lacks interest coupons and so requires presentation upon each payment of interest.

The term "debenture" ordinarily, although not necessarily, refers to an unsecured bond. A "certificate of indebtedness" is primarily any instrument acknowledging liability for the payment of money, not in the recognized

form of a promissory note or bill of exchange. Certificates of deposit, however, are not taxed.

T. D. 2257 of October 30, 1915, is affirmed.

DANIEL C. ROPER
Commissioner of Internal Revenue.

Approved May 14, 1918:

L. S. ROWE,
Acting Secretary of the Treasury.

Appendix B

Extracts from Regulations No. 55, T. D. 3094, 22 Treas. Dec. Int. Rev. 502 (1920).

"ART. 8. Instruments issued by corporations in numbers, under a trust indenture, are bonds.—Instruments containing the essential features of a promissory note, but issued by corporations in series, secured by a trust indenture, either in registered form or with coupons attached, embodying provisions for acceleration of maturity in the event of any default by the obligor, for optional registration in the case of bearer bonds, for authentication by the trustee, and in some instances for redemption before maturity, or similar provisions, are bonds within the meaning of the statute, whether called bonds, debentures, or notes."

* * * * *

"ART. 10. Instrument styled a bond and under seal a bond, unless.—An instrument which is styled a 'bond' and which is under seal should be held subject to tax as a bond unless it is shown affirmatively that it is not a bond."

* * * * *

"ART. 14. Certificates of indebtedness.—(a) The term 'certificates of indebtedness' includes only instruments having the general character of investment securities as distinguished from instruments evidencing debts arising in ordinary transactions between individuals.

(b) Conditional bills of sale used in the sale of merchandise on the installment plan are not certificates of indebtedness within the meaning of Schedule A 1 and are

not subject to stamp tax unless containing an obligation in the form of a promissory note."

* * * * *

"Art. 48. 'Promissory notes.'—(a) A promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time a sum certain in money to such other person, or to order or to bearer, free from restrictions as to registration or transfer, and usually without coupons.

(b) The stamp tax on a promissory note is measured by the amount of the principal obligation without regard to the form in which the obligation to pay interest is expressed."

* * * * *

"Art. 58. Coupons and interest notes.—(a) Coupons attached to bonds, debentures, or certificates of indebtedness issued by any individual, partnership, or corporation, or to instruments, however termed, issued by a corporation and known generally as corporate securities (all of which are subject to tax as bonds of indebtedness under Schedule A 1), are not subject to tax if they impose no obligation not imposed by the principal instrument.

(b) Interest coupons attached to promissory notes taxable under Schedule A 6, as distinguished from the securities enumerated in paragarph (a), if they are themselves promissory notes, separable from the principal obligation and negotiable independently of it, are subject to tax, even though they impose no obligation not imposed by the principal instrument."

Appendix C

SEC. 1107-A-1, REG. 55, ART. 8: Bonds of indebtedness described.

(See ST. 1-20-85, sec. 1107-A-1, Reg. 55, art. 14.) What are "Certificates of indebtedness"?

SEC. 1107-A-1, REG. 55, ART. 14: Conditional bills of sale. ST. 1-20-85. I.O. 909.

(Also Sec. 1107-A-1, Reg. 55, Art. 8.)

The term "certificates of indebtedness" as used in subdivision 1, Schedule A, Title XI, Revenue Act of 1918, includes only instruments having the general character of investment securities as distinguished from instruments evidencing debts arising in ordinary transactions between individuals.

Conditional bills of sale are not certificates of indebtedness.

T.D. 2713 should be modified to conform to this holding.

The question is presented as to the meaning of the term "certificates of indebtedness" as used in subdivision 1, Schedule A, Title XI, Revenue Act of 1918. This question arises in connection with conditional bills of sale, variously worded, used in the sale of merchandise on the installment plan.

Subdivision 1 of Schedule A provides:

Bonds of indebtedness: On all bonds, debentures, or certificates of indebtedness issued by any person, and all

instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 5 cents. * * *

The instruments taxable under this subdivision are "bonds of indebtedness." Under this denomination two classes of instruments are included:—First, "all bonds, debentures, or certificates of indebtedness issued by any person"; and, second, "all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities." The term "person" for the purposes of the Revenue Act of 1918 is defined (sec. 1) as including "partnerships and corporations, as well as individuals." Thus all bonds, debentures, or certificates of indebtedness issued by any individual, partnership, or corporation are subjected to the stamp tax imposed by this subdivision *eo nomine*.

The words "all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities," were clearly added in recognition of the varied forms in which corporate securities are issued, and to defeat any attempt by a corporation to avoid the tax by issuing instruments of the general character of bonds, debentures, or certificates of indebtedness under a different name. In re Stark's Will, 149 Wis. 631, 134 N. W. 389, 399, it was said:

While the word "securities" construed strictly does not cover corporate stock, but rather bonds or evidence of debt, it has undoubtedly acquired a much broader meaning by general usage. It is said in 25 A. & E. Ency. of Law at page 180: "The term in its broadest sense em-

braces bonds, certificates of stock, promissory notes, bills of exchange," etc. The Century Dictionary defines securities as "evidences of debt, or of property; as a bond or certificate of stock." See 1 Cook on Corporations (6th Ed.), secs. 14 and 305, to the same effect.

But as used in this subdivision it is clear that the word "securities" is used in its strict sense, since they are required to be "issued * * * with interest coupons or in registered form." Moreover, certificates of stock, promissory notes, and bills of exchange are separately taxed under subdivisions 3 and 6 of said Schedule A. The words "known generally as corporate securities" therefore limit the broader language which precedes them to instruments of the general nature of corporate bonds or evidences of corporate debt.

Bonds, i. e., bonds of indebtedness, are too familiar to require extended definition. Their essential characteristic is that they are executed under seal. The Century Dictionary defines "debenture" as "A writing acknowledging a debt; specifically, an instrument, generally under seal, for the repayment of money lent; usually, if not exclusively, used as obligations of corporations or large moneyed copartnerships, issued in a form convenient to be bought and sold as investments." This definition was adopted by the court in Barton Nat. Bank *v.* Atkins, 72 Vt. 55; 47 Atl. 176, 180. The term "certificates of indebtedness" has also come to have in commercial use a similar meaning. In Denver *v.* Home Savings Bank, 236 U. S. 101, 105, the court said:

What is true about bonds is true about certificates of indebtedness. Indeed it is difficult to see any distinction

between them as they are commonly known to the business world. The essence of each is that they contain a promise under seal of the corporation to pay a certain sum to order or bearer.

If the term "certificates of indebtedness" standing by itself be susceptible of a broader meaning than that given to it above, its association here with bonds and debentures excludes such broader meaning. The maxim *noscitur a sociis* applies.

A consideration of Title XI as a whole supports the conclusion above arrived at. Three classes of paper issued by individuals, partnerships, and corporations are subject thereunder to stamp tax: Bonds of indebtedness (subdivision 1), certificates of stock (subdivision 3), and drafts or checks and promissory notes (subdivision 6); i. e., instruments possessing to a greater or less extent the attributes of commercial paper.

The premises lead inevitably to the conclusion that it was not the intention of Congress to tax under subdivision 1 of the said Schedule A every evidence of indebtedness other than those included under the heads of shares or certificates of stock, promissory notes, or bills of exchange, but only those evidences of indebtedness which have the general character of investment securities and which may properly be included under the term "bonds of indebtedness." The definition of "certificate of indebtedness" as "primarily any instrument acknowledging liability for the payment of money, not in the recognized form of a promissory note or bill of exchange," contained in T. D. 2713, is too inclusive and does not sufficiently delimit the instruments included in the term.

It is therefore held that the term "certificate of indebtedness" as used in subdivision 1 of Schedule A, Title XI, Revenue Act of 1918, includes only instruments having the general character of investment securities, as distinguished from instruments evidencing debts arising in ordinary transaction between individuals; and that conditional bills of sale are not certificates of indebtedness.

T. D. 2713 should be modified to conform with this holding.

ROBERT N. MILLER,
Solicitor of Internal Revenue.

IN THE

Supreme Court of the United States

October Term, 1954

No. [redacted] 74

UNITED STATES OF AMERICA,
Petitioner,

v.

LESLIE SALT COMPANY,
Respondent.

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

Comes now Plymouth Oil Company, by its undersigned counsel, and respectfully moves this Court for leave to file brief amicus curiae, and in support thereof shows as follows:

1. Plymouth Oil Company, a corporation organized under the laws of Delaware, with principal offices at Pittsburgh, Pennsylvania, is the plaintiff in Civil Action No. 10[illegible]22 in the United States District Court for the Western District of Pennsylvania in a suit for refund of documentary stamp taxes imposed by the Collector of Internal Revenue under Section 1801 of the 1939 Internal Revenue Code on promissory notes issued by Plymouth Oil Company as evidence of a commercial loan secured from its regular commercial bank.

2. An examination of the petition for certiorari and brief in opposition in the instant case discloses that the same general question of the applicability of the Section 1801 tax is involved herein.

3. An examination of the petition discloses also that petitioner proposes to urge this Court that "instruments evidencing long-term loans which contain . . . detailed restrictions on the borrower for the lender's benefit" are subject to this tax; that the only instruments free thereof are those "notes used customarily in day to day commercial transactions of a short time credit character"; and that this Court should somehow define the term "debentures" so as to produce this result. The government has advanced these same contentions in its petition to this Court for a writ of certiorari to the United States Court of Appeals for the Third Circuit in *Smith* v. *The Curtis Publishing Company*, No. 254. As pointed out in that petition, the Circuit Court held that the documentary stamp tax did not apply to instruments evidencing the loan made by the borrower's regular commercial bank in the ordinary course of its regular commercial loan business to a commercial depositor.

4. The government's analysis thus renders irrelevant all other factors in the case, including such matters as the relationship between the lender and the borrower and the fact of whether the instrument in dispute is a marketable investment security or simply evidence of a loan from the lender to the borrower.

5. It would be the purpose of the proposed brief amicus curiae to urge the Court that the factors referred to in paragraph 4 and other related factors are important; that with very limited exception, the decided cases fall into two categories with reasonably well-defined boundaries; and that as properly held in *Niles-Bement-Pond Co.* v. *Fitzpatrick*, 213 F(2d) 305 (2d Cir. 1953), each case must be decided on the basis of all of its facts.

6. In view of the fact that the parties in the instant case are inevitably concerned with the precise facts in the instant case, counsel feels that it would be helpful to this

Court to have before it a separate brief dealing only with the fundamental problems involved in this overall question which is of real importance in the field of corporate financing.

7. As indicated by the consent herewith filed, counsel for petitioner has consented to the granting of this motion. Counsel for respondent has seen fit to withhold his consent.

WHEREFORE, it is respectfully requested that this Court grant this motion.

Respectfully submitted,

EDGAR J. GOODRICH

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OFFICE OF THE SOLICITOR GENERAL
Washington, D. C.

June 21, 1955

Lipman Redman, Esquire
Guggenheimer, Untermyer, Goodrich & Amram
Ring Building
Washington 6, D. C.

Re: United States v. Leslie Salt Co.
~~No. 74.~~

Dear Mr. Redman:

I have your letter of June 16, in which you request consent to the filing of an *amicus* brief in the above-entitled case on behalf of Plymouth Oil Company of Pittsburgh, Pennsylvania.

Your letter states that you represent the Company in a case pending in the United States District Court for the Western District of Pennsylvania, involving substantially similar issues to those in the *Leslie Salt* case. You state, further, that your brief will deal with points which will probably not be covered at all in respondent's brief. Accordingly, I am happy to consent to your request.

Sincerely yours,

/s/ Simon E. Sobeloff
Simon E. Sobeloff,
Solicitor General.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 74

UNITED STATES OF AMERICA,

Petitioner,

vs.

LESLIE SALT CO.,

Respondent.

BRIEF OF RAYONIER INCORPORATED.
AMICUS CURIAE.

CHESTER ROHRLICH,
Attorney for Rayonier Incorporated,
Amicus Curiae.

LEHMAN, GOLDMARK & ROHRLICH,
20 Pine Street,
New York 5, New York.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1955

No. 74

UNITED STATES OF AMERICA,

Petitioner,

vs.

LESLIE SALT CO.,

Respondent.

BRIEF OF RAYONIER INCORPORATED, *AMICUS CURIAE*

The affirmance of the decision below (218 F. (2d) 91, aff'g 110 F. Supp. 680) is necessary to and should set at rest the erroneous notion that seems to have crept into certain of the cases to the effect that the taxability of an instrument evidencing a debt under Section 1801 of the Internal Revenue Code of 1939* may depend upon the

* Section 1801, in conjunction with Section 1800, of the Internal Revenue Code of 1939 (53 Stat. 1,195), substantially re-enacted as Sections 4311, 4331 and 4381 of the Internal Revenue Code of 1954, imposed a tax "on all bonds, debentures or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities. * * *"

identity of the lender, more particularly whether the lender is a bank or an insurance company.[2]

Interest of *Amicus Curiae*

The interest of this *amicus curiae* in the case at bar stems from the fact that it borrowed a substantial sum of money from an insurance company, evidencing such loan by its note, in respect of which United States documentary stamps, under Section 1801 of the Internal Revenue Code, were affixed. A claim for the refund of such tax was rejected by the Commissioner of Internal Revenue, but the time within which suit for its recovery may be brought has not yet expired.

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2 "The prospective borrower who seeks funds in the amount and under the conditions which we are presently considering usually negotiates with a bank or an insurance company. There is no reason why either type of institution should be considered incapable of receiving, or less likely to receive, a 'note' in return for funds which it supplies. The chronology of appellate decisions in this area of the law has unfortunately led to a presumption against the insurance company which lasted until a denunciation by the United States Court of Appeals for the Ninth Circuit, in December of 1954 (U. S. v. Leslie Salt Co.)." Jensch, Documentary Stamp Taxes: The Twilight Zone of Their Application to Large Corporate Loans, 33 Taxes 605, 613 (August 1955).

Both before and since the decision below certain other courts have also recognized the immateriality of the fact that the lender is an insurance company. In *Allen v. Atlanta Metallic Casket Co.*, 197 F. (2d) 460 (C. A. 5, 1952), aff'g [illegible] F. Supp. 404, notes to an insurance company were held non-taxable. In *Motor Finance Corp. v. U. S.*, 54-2 USTC par. 49,057 (D. C., N. J., 1954), app. dis. C. A., 3rd Cir., CCH Fed. Tax Rep. (Supp.) 67,226, *Knudsen Creamery Co. v. U. S.*, 121 F. Supp. 800 (D. C., Cal., 1954), *U. S. v. General Shoe Corp.*, 117 F. Supp. 668 (D. C. Tenn. 1953), no distinction was drawn between notes given to a bank and to an insurance company.

ARGUMENT

The impact of the tax is by the statute unequivocally made dependent upon the nature of the instrument itself. Nothing in the statute justifies making the imposition of the tax upon an instrument dependent on the identity of the lender or its motive in making the loan* or its internal procedures in processing the loan.

Equally without legal significance in this context are the "attitude and need of the borrower". *Niles-Bement-Pond* v. *Fitzpatrick*, 213 F. (2d) 305, 312 (C. A. 2, 1954). Judge Clark's dissenting opinion in the cited case noted that in the earlier decision of the same Court in the *General Motors Acceptance* case (161 F. (2d) 593, cert. den. 332 U. S. 810) these very indicia had been relied on but that their relevance was no longer recognized by the majority in the later case. Surely there is no warrant in the statutory language for making the imposition of the tax dependent upon whether the borrower uses the proceeds of the loan to build a new building, buy inventory or pay a pre-existing debt.

Neither does the statute permit the determination of taxability on the basis of the amount or duration of the loan.** Nor is there any warrant for penalizing new busi-

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* "* * * it is apparent that the lender's motive in treating the transaction as loan or investment is not a helpful guide in determining taxability. Under this view the borrower is subject to the tax when the lender 'intends to invest.' But since privately placed loans are generally treated as investments and term loans do not fall within either category, if this distinction is pursued it is conceivable that a term loan note negotiated with the loan department of a bank would be nontaxable though an identical note privately placed with an insurance company would be taxed.". Note, 54 Columbia Law Review 428, 431 (1954).

The measure of taxability proposed by the writer of the cited Note obviously requires Congressional consideration and legislation.

** *Curtis Publishing Co.* v. *Smith*, 124 F. Supp. 508 (E. D. Pa., 1954), aff'd 220 F. (2d) 748 (C. A. 3, 1955); *Niles-Bement-Pond Co.* v. *Fitzpatrick*, *supra*.

ness relationships by making taxability hinge on whether the loan is or is not the first one between the parties.

The tax here under review has been on the books in substantially its present form since at least 1924, and at no time has Congress seen fit to enact as criteria of taxation any of these extraneous elements unfortunately generated, to the confusion of the business world, by several of the judicial opinions purporting to apply Section 1801. The legislative history of the tax contains not only the failure of the Congress to adopt such criteria but also the affirmative repeal in 1924 of the tax theretofore levied on promissory notes.* Until the rendition in 1947 of the *General Motors Acceptance* decision not even the Commissioner of Internal Revenue conceived that corporate notes of the kind here under discussion were subject to tax under Section 1801 (M. T. 32, 1948—2 Cum. Bull. 160). There is no need or justification for judicial legislation.

There is no legally significant difference between a loan by an insurance company and one by a bank. Yet Judge (now Justice) Harlan, in writing the prevailing opinion for the Second Circuit holding that the loan in the *Niles-Bement-Pond* case was not taxable—notwithstanding the decision by the same Court in the *General Motors Acceptance* case—noted as a point of distinction between the two cases that in the later case the loan had been made by a bank and not by an insurance company as in the earlier case. In the case at bar a witness for the taxpayer testified, without contradiction, that "the only fundamental difference between a bank loan and an insurance company note seems to lie in the fact that the insurance companies are in a

* The Revenue Act of 1921 (42 Stat. 227, 305) imposed a stamp tax on "promissory notes, except bank notes issued for circulation" (Tit. XI, Sch. A, subd. 5). The Revenue Act of 1924 (43 Stat. 253, 352, 331) repealed Title XI of the 1921 Act (Section 1100) and imposed the tax on bonds and debentures substantially in the form now before the Court (Tit. VIII, Sch. A, subd. 1).

position to extend longer maturities than can a commercial bank" (R. 63).

It may be that insurance companies in making private loans to corporations are entering into an area of business formerly pre-empted by commercial banks resulting in a deprivation of business to investment bankers and underwriters, but in the American economic system business entities are subject to changes in their activities, and so long as no violation of law is involved it is not within the judicial function to construe statutes in a manner prejudicial to one form of business organization or impede the free play of the competitive process. Thus, Judge Clark, who dissented in the *Niles-Bement-Pond* case, recognized that "the kind of one-sided advantage to bank loans now read into the act" is to be "deplored" (213 F. (2d) at 313).

The discrimination against insurance company loans in this area of the law seems to have been the result of a misguided attempt to distinguish between a "loan" and an "investment". At the outset, it may be observed that even if such distinction could logically and objectively be made, it would be without legal significance because the statute here under consideration does not levy a tax on an "investment" as distinguished from a "loan". Because of the requirements of the Securities Act of 1933 and certain state legislation, which are wholly irrelevant to the tax question here under review, it has become customary for loan agreements, where no public distribution of securities is involved or anticipated, to include a declaration by the lender to the effect that the instrument being acquired by it is "for investment". It would seem that if such declaration and fact have any significance under Section 1801, it is to militate against taxability rather than to support it. Debentures and like corporate securities, sought to be taxed by Section 1801, are ordinarily acquired by the initial purchaser for resale and distribution and not for investment by it. It is difficult to understand how a contrary sig-

nificance can be given to the fact that the lender intends to hold and not to market the instrument. Surely, marketing and marketability are primary aspects of "corporate securities" as generally understood.

Moreover, the entire dichotomy between "loan" and "investment" is a deceptive one. Every lender expects to receive back the amount of the loan plus interest and or a premium for furnishing the monies, and in such sense every loan is an investment. Judge (now Justice) Harlan, in the *Niles-Bement-Pond* case, recognized that "a bank as well as an insurance company in a sense intends to invest when it lends money, whether the transaction be called a loan, a private placement or a public issue" (213 F. (2d) at 314). Rather than classifying the debt instrument in terms of investment, loan, private placement or public issue, Section 1801 requires classification in terms of a promissory note on the one hand or a bond, debenture, certificate of indebtedness, or a corporate security with interest coupons or in registered form on the other.

It does not follow from our argument that a debt instrument escapes taxability merely because the contracting parties have labelled it a "note". But it should be equally evident that under the Congressional mandate judicial determination of taxability must be based on the character and substance of the debt instrument itself and not upon findings as to the motives and intent of the borrower and lender, or the manner in which the loan was initiated or negotiated. It is only because of judicial speculation in respect of such matters that there has seemingly developed in the cases a prejudicial attitude against insurance company loans.

CONCLUSION

The judgment should be affirmed.

Respectfully submitted,

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